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Foreign Aid and the Bottom Billion

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There are many contrasting opinions about foreign aid, from the optimism of Jeffrey Sachs in *The End of Poverty* to the scepticism of William Easterly in *The White Man's Burden*. How aid affects economic development remains unresolved. This debate is important because of its implications for donor policies and their effects in poor nations. The challenge is to bridge the divide between the cross-country econometrics on which Paul Collier relies in *The Bottom Billion* and country-specific analysis that is useful for governments and aid agencies. In this In Focus brief key aid messages from Collier's book are identified, analysed, and their policy implications discussed.

Aid alone cannot end poverty

Collier recognises the limitations of aid. The argument that aid on its own cannot end poverty is widely shared, and even recognised by aid optimists. The authors of *Ending Africa's Poverty Trap* emphasise that 'large-scale aid is not sufficient for ending the poverty trap' (Sachs *et al.* 2004: 186–187). The importance of complementary policy reforms, such as improved access to developed country markets, also finds broad agreement throughout the literature (Commission for Africa 2005).

Aid failures

Collier points to two broad sources of failure in aid policy. First is the way in which the aid system has been designed

Collier on foreign aid

Collier goes beyond the often polarised views about aid and explicitly positions himself in the middle ground, recognising both past failures and successes. Six messages on aid stand out from *The Bottom Billion*: aid alone cannot end poverty; aid has not always worked well in the past; but aid has supported economic development in poor countries; aid should be targeted towards the Bottom Billion; aid should be tailored

to specific growth challenges in individual countries; and aid agencies are responding to a mistaken reform agenda.

Collier's focus is restricted to the routine activities of major aid agencies (i.e. Official Development Assistance – ODA), neither humanitarian aid nor Non-Governmental Organisations (NGOs) are given attention.

and managed. Collier's views here reflect an established body of evidence reviewed in detail by Riddell (2007). The second source of aid failure concerns economic constraints to aid effectiveness, including absorptive

capacity and Dutch Disease, through which large inflows of foreign currency can have a negative impact upon agricultural and manufacturing exports. The evidence Collier presents is somewhat cursory, and it is not clear

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that these potential constraints operate in either an automatic or equal fashion across countries. Even Collier himself elaborates on how foreign currency inflows can be managed, and various case studies show that substantial aid flows to African countries have not been accompanied by significant Dutch Disease (IMF 2005; Killick and Foster 2007).

Aid achievements

The cautious tones of the previous two points are tempered by Collier's recognition that aid is not ineffective in general. Collier estimates that over the last 30 years aid has increased the annual growth rate of the poorest countries by 'around one percentage point' and that 'Without aid, cumulatively the countries of the bottom billion would have become much poorer than they are today' (2007: 100). Positive assessments of aid are supported by numerous aid project evaluations which show strong rates of return. At the aggregate cross-country level, where Collier directs his attention, the evidence is controversial. In his support, the broad direction of results from rigorous econometric studies is that *on average* aid has a modest positive impact on growth, but Collier does not discuss the quality of this evidence, including that results are fragile and sensitive to both data and methodological choices (Tarp 2006; Bourguignon and Sundberg 2007).

Targeting aid to the Bottom Billion

It is not contentious to make the point (as Collier does) that past aid allocations have been influenced by political and historical ties rather than objective needs alone (Alesina and Dollar 2000). But Collier goes further. He holds that the allocation of aid has diverged from an identifiable 'poverty-efficient' distribution as 'far too much aid was going to middle-income countries' (2007: 104), and this justifies his focus on the Bottom Billion. We agree there is a need to target aid better, but would caution that the empirical understanding of the dynamic interactions between aid and development remains weak. To quote Pritchett 'The rule of growth in developing countries is that anything can happen and often does' (2000: 247). On reading *The Bottom Billion* the layman would be forgiven for thinking that these issues have been cracked. They haven't.

Tailoring aid to specific countries

Collier's agenda to make aid more effective is that it should be tailored to a country's specific needs. He develops a framework in which different forms and volumes of aid can be employed to help 'break' different poverty traps. For example, Collier advises that large aid-financed investments in regional infrastructure are essential for landlocked countries. Even for countries trapped by

poor governance, Collier is convinced that higher levels of project supervision, governance conditionality and the creation of independent public service agencies can make aid effective. This is a fairly optimistic position, entailing an active and wide role for aid across Bottom Billion countries, including failing states and countries in need of policy reform. Although contentious, Collier recognises valid roles for technical assistance as well as for infrastructure finance and sustained post-conflict aid, on which there is broader agreement. Numerous country case studies provide supporting evidence for the latter two with Mozambique being an obvious example (Arndt *et al.* 2007). However, there are concerns with Collier's agenda to tailor aid:

- Collier does not identify the 58 Bottom Billion countries, although his framework demands an exact diagnosis of the status of each country at any given time. Even with hindsight there are likely to be major disagreements as to a given country's status at a particular time. Is Zambia locked in a poverty trap? And what about Kenya now? Collier does not really show us how to bridge the gap between his preferred approach to economic analysis (dominated by cross-country empirical studies) and the rigorous, real-time country diagnoses needed for the kinds of aid interventions he advises. To put this challenge in perspective, Riddell notes

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the consistent failure of aid agencies to understand real country circumstances (2007).

- Many of Collier's suggestions are not fully tested and do not meet his high standards of empirical validity. The failure to get meaningful policy change when it is made a *pre*-condition for aid does not imply giving aid as a reward for past policy reform will work either. Making *ex post* conditionality functional, at least in its current guise of performance-based conditionality, is far from straightforward (Adam *et al.* 2004). The practicality of independent public service authorities is also hard to envisage, not least due to questions over sovereignty and accountability.

Aid agency reform

Collier argues that aid agencies need to become fleet of foot, less risk averse and better coordinated. He also feels that public opinion is pushing reforms in an opposite direction, although the truth of this is not well established and public opinion about aid would appear to vary across countries. It is a problem that Collier tends to treat all aid agencies alike, particularly given his emphasis on the importance of global institutions (2007: Chapter Nine). The reader may wonder about the balance between multilateral and bilateral aid agencies. It also is not self-evident that higher administrative overheads for project supervision will help agencies be more

fleet-footed, nor is it clear how agency reform can occur in a harmonised fashion.

Conclusion

It is helpful to distinguish between Collier's analysis of aid in the past and his suggestions for the future. On the former Collier makes a strong and convincing case for a middle-ground – aid does have a mixed record. Collier's agenda for the future is refreshing and merits serious consideration. He appears confident that he has cracked the riddle about how aid works and, thus, knows how to do better aid. Our understanding of the literature would suggest greater caution. Uncertainties remain and should have been more clearly recognised and discussed. Understanding the dynamics of aid and aid's performance requires a far wider range of evidence.

Collier has also left gaps to be filled. The role of 'country ownership', often viewed as the only genuine solution to conditionality problems (Koeberle 2003: 270), is particularly difficult to fit into Collier's framework. Similarly, Collier does not discuss the contribution of aid in support of primary education, health and agriculture. This cannot be because they are irrelevant to economic growth. Overall, Collier has made an important contribution to the aid debate, but this is hardly the final word.

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“ Empirical understanding of the dynamic interactions between aid and development remains weak. ”

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Credits

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