## 1. Introduction

In *Dead Aid*, Moyo (2009) forcefully argues that aid is the primary cause of all ills in African society today. While she suggests that Africa's ongoing failure to generate any long-term growth is arguably a confluence of separate geographical, historical, cultural, tribal and institutional factors, she goes on to observe that, "no factor should condemn Africa to a permanent failure to grow. This is an indictment Africa does not deserve. While each of these factors may be part of the explanation in differing degrees in different countries, for the most part African countries have one thing in common- they all depend on aid" (p. 35).

Moyo's (2009) main thesis is one that is gaining a great deal of currency in the development community. She argues that aid serves to stifle, "desperately needed investment, instills a culture of dependency, and facilitates rampant and systematic corruption, all with delirious consequences for growth" (p. 49). It enables poverty and weakens civil society by increasing the burden of government and reducing civil freedoms.

This essay will expand on some of the ideas presented by Moyo (2009) and examine some of the threats and opportunities for development posed by aid. Is it as destructive as she claims, or can it genuinely be used to change the lives of people living in poorer nations for the better? The following section of this assignment will introduce the reader to the concept of aid. This paper will then look at two possible threats posed by aid. These are macroeconomic instability and corruption. Following this discussion, this paper will then turn to consider two potential opportunities for development created by aid: economic growth and education.

## 2. What is Aid?

Moss et al (2006) suggest that aid can best be understood in terms of a subsidy. Aid is supposed to provide the recipient with temporary assistance in order to encourage the development of long-term behaviours such as revenue collection, investment in physical and human capital and the establishments of institutions. As this happens, the need for aid should diminish since the receiving country should have the capability to pay its own way. Proponents of aid as a tool for development suggest that it can be targeted into areas such as education, health and infrastructure. Improvements in these areas should help to slowly create the conditions necessary to wean countries off of aid.

That is the theory. However, decades of experience have gone some way towards showing that this is rarely the case. Moss et al (2006) argue that aid has, "discouraged revenue collection, distorted expenditure decision-making, and undermined the incentives to build state capacity. In these cases, aid could be viewed as not only a crutch delaying institutional development, but as potentially undercutting those efforts" (p. 6). It has created dependency, increased corruption and led to macroeconomic instability. The following section of this paper will look at the potential threats and opportunities to development caused by aid.

## 3. Threats to Development

The following section of this assignment will outline two major threats to development posed by aid. These are: macroeconomic stability and corruption.

### 3.1: Macroeconomic Instability

Hansen and Tarp (2000) suggest that the early literature viewed foreign aid as an exogenous net increment to the capital stock of the receiving nation. Put very simply, this view suggested that each aid dollar received would result in an increase of one dollar in total savings and investment. Hansen and Tarp (2000) state that, "aid was not treated as a component of national income adding to both consumption and investment. Hence, fungibility of aid resources was not allowed for, and aid for consumption purposes was skipped over in this type of macroeconomic aid-impact analysis" (p. 377).

However, more recently there has been a backlash against this idea. Some macroeconomists argue that a sizeable inflow of aid will cause macroeconomic instability by raising inflation and appreciating the real effective exchange rate (REER). This process is referred to as the Dutch Disease. Rajan and Subramanian (2005a) suggest that there are two ways by which this could happen.

Firstly, they suggest that aid inflows serve to appreciate the nominal exchange rate. This could lead to lead to reduced competitiveness in the traded goods sector if wages are not adjusted downwards. Secondly, Rajan and Subramanian (2005a) argue that in fixed exchange rate regimes, when aid is spent on domestic goods the price for other critical resources that are needed domestically will increase (for example, skilled worker wages). This makes export industries and other industries, such as manufacturing, that depend on these same resources uncompetitive. They state that aid inflows, "result in an overvalued real exchange rate, and hence have adverse consequences on the growth of the traded goods sector in recipient countries" (p. 5).

Adam and Bevan (2003) argue that the harmful effects of the Dutch Disease can mitigated if the government uses the aid to invest in public infrastructure as this can improve productivity in the tradable and non-tradable sectors. Nkusu (2004) further suggests that countries with large aid flows can escape Dutch Disease if they are able to: 1) draw upon idle productive capacity to meet the demand for non-tradables that aid inflows cause; 2) implement reforms that allow resources to move into areas that facilitate high rates of return; 3) pursue macroeconomic policies that will deliver sustainably low rates of inflation that will offset the depreciation of the REER.

One area where resources arguably facilitate high rates of return is in infrastructure investment. McKinley (2005) observes that if a government chooses to use aid to purchase domestic goods and services, the potential inflationary impacts could be mitigated through investment in public goods such

as infrastructure projects. McKinley states that, "such infrastructure increases the productivity of the private economy- eventually expanding aggregate supply in order to match the increase in aggregate demand from government expenditures. Under these circumstances, public investment will 'crowd-in', or stimulate, private investment"(p. 4). One positive result of this 'crowd-in' is that it expands the tax base and increases tax revenues that the government is able to collect.

An example of this can be witnessed in Kenya. A recent article in *The Guardian* (2012) points to how the Kenyan government is using aid on sustainable and useful infrastructure projects. The article presents the case of the improvement of the Nairobi-Thika highway. This major project has made real estate exponentially profitable in the area, which has led to an influx of private investors. The article argues that this will have a positive and indirect effect on the amount of taxes the Kenyan government is able to collect as more people establish and expand businesses. Investment in other infrastructure projects has also allowed companies such as Safaricom and East African Breweries Limited to thrive. Their success has allowed them to employ more people, which widens the tax base in Kenya. In the long-tem this should reduce the country's dependence on aid.

### 3.2: Corruption

Alesina and Dollar (2002) argue that there is very poor correlation between aid and the recipient country's economic performance. They suggest that aid is instead strongly related to the cultural and historic proximity between donor and recipient country. Kenya and the UK, for example, share a long colonial history, which probably explains why Kenya is one of the main recipients of UK aid. DfID will spend an average of £128 million per year between 2011-2015 on various programmes in the country (DfID, 2012). When aid follows these historic and cultural ties rather than real need, there is arguably greater scope for corruption. Tavares (2003) states that, "if aid is not channeled to productive uses or to poverty reduction, it may be going somewhere else. One possibility is that aid is channeled to uses that promote corruption" (p. 100).

Corruption is shown to have a negative impact on economic growth and also on investment. Corruption also makes it difficult for governments to raise revenue to fund public services. Corruption forces businesses that might otherwise be legitimate underground, where they can avoid paying taxes. Tavares (2003) points out that due to the fact that some bribes are harder to collect than others, corruption biases the provision of public goods away from education.

Moss et al (2006) argue that large aid flows can cause governments to become less accountable, and therefore more corrupt, because governing elites no longer need public backing and the assent of their legislatures when they don't need to raise revenues (i.e. through taxation) from the local economy. Moss et al (2006) suggest that it becomes more important to keep donors happy than the electorate. Although governments tend to complain about the conditions usually attached to aid, it is easier to manage donor demands than it is to improve or

introduce domestic revenue collection. They argue that, "a reliance on aid as a substitute for local resources means the flow of revenues to the state is not affected by government efficiency, so there will be a tendency for governments to under-invest in developmental capacity" (p. 15). Heller and Gupta (2002) suggest that this creates a moral hazard since it reduces the incentive to implement reforms on under performing institutions, thereby weakening the government's developmental performance. Tavares (2003) argues that, "corrupt countries may become poor performers and find themselves relying increasingly on international aid. In the ensuing vicious circle, a possible link between foreign aid and corruption may be not only harmful but also self-reinforcing" (p. 101).

Those in favour of financial aid would argue that it is possible to ring-fence projects against sleaze and corruption. This is certainly the view taken by DfID. However, this rarely seems to be the case. Michela Wrong's (2009) account of Kenya's corruption tsar turned whistleblower, John Githongo, focuses a great deal of attention on how aid enabled the culture of bribery and corruption that became endemic in both Moi and Kibaki's governments. She quotes Daniel Kaufmann, the former Director of Global Programmes at the World Bank Institute who argues that, "the idea that donors can immunize their projects in a corrupt country is absurd, it's not what the evidence show. When there is no integrity on the part of the leadership, no systematic approach to governance, civil liberties, rule of law, donor aid is simply wasted" (as cited by Wrong, 2009: 207). A World Bank study, also cited by Wrong, suggests that between 2000 and 2005, three of the four projects approved by the bank in Kenya were found to have suffered from 'serious irregularities'. Two of the projects highlighted in the report were AIDS-related and Wrong (2009) uses them to highlight, "one of the most obscenely ironic consequences of abuse" (p. 208). Grant money went to bribing officials rather than being spent on orphans' school fees. This meant that many children dropped out of education and resorted to prostitution. Wrong (2009) concludes that, "a project intended to reduce HIV infection helped, instead, to spread the virus" (p. 209).

Wrong (2009) suggests that this is not helped by the fact that DfID's success is measured by how much it is able to disburse. Even in austerity Britain, DfID has seen its budget increase. It is almost a case that it has more money than it knows what to do with. This perhaps means that transparency is not the main concern. Wrong (2009) argues that, "once you subtracted oil and mineral rich African states that didn't need foreign aid, then removed those which were undoubtedly dirt poor but whose leaderships were considered beyond the pale, the list of governments meeting the criteria for partnership became embarrassingly short" (p. 209). This has allowed countries like Kenya to claim a large chunk of the aid money available. Accountability is weak as there is arguably little willing to investigate if money is being spent wisely.

It should be noted that the tide is arguably turning here. In 2011, the UK government appointed a commission to look into whether the British government is getting full value for the money spent on development projects in countries such as Kenya. Githongo, the subject of Wrong's book, has been appointed as one of the four members on the commission (The Guardian, 2011).

## 4. Opportunities for Development

Aid also presents numerous opportunities for development. The following section will focus on two such opportunities: economic growth and education

### 4.1: Economic Growth

Rajan and Subramanian (2005b) state that one of the most enduring and contentious questions in economics is whether foreign aid helps countries to grow. The evidence so far has arguably been inconclusive. Burnside and Dollar (2000), for example, suggest that aid has a positive impact on growth in recipient countries with strong fiscal, monetary and trade policies. However, if these areas are weak, aid is likely to be ineffective.

Growth is important because it expands the opportunities for a society. It improves the outcomes and opportunities for individuals living within it. Ranis (2004) argues that, "income growth clearly strikes one as the main contributor to directly increasing the capabilities of individuals and consequently the human development of a nation since it encapsulates the economy's command over resources" (p. 3). However, how to achieve growth, especially in developing countries, is what has puzzled economists for decades. One of the most popular instruments for achieving growth has been aid. However, the effectiveness of this approach is now more than ever under attack.

Easterly (2003) is one of the most vocal critics against the idea that aid leads to growth. He argues that aid agencies have spend far too long looking for the 'Next Big Idea' that might enable aid to buy growth. He points to the incredible variety of institutions, histories, cultures and social structures in place in the countries receiving aid. He states that, "the idea of aggregating all this diversity into a "developing world" that will "take off" with foreign aid is a heroic simplification" (p. 40). He goes on to suggest that, "in virtually no other field of economics do economists and policymakers promise such large welfare benefits for modest policy interventions as "we" do in aid and growth. The macroeconomic evidence does not support these claims. There is no Next Big Idea that will make the small amount of foreign aid the catalyst for economic growth of the world's poor nations" (p. 40). Roodman (2004) tows a similar line, suggesting that, "aid seems to work outside the tropics but not in them" (p. 11).

Easterly (2003) argues that while it is laudable for high-income people to make some sort of transfer to the very poorest, the goal of aid should not be to move as much money as politically possible or to engender the transformation of whole societies from poverty to wealth. He states that the goal should simply be, "to benefit some poor people some of the time" (p. 40).

### 4.2: Education

Little (1999) suggests that education now occupies a central position in development discourse. She observes that this shift came about during the

1990s, when development agencies increasingly presented the role of education in development in a positive light. Education came to be viewed, "as a vital ingredient in meeting global, as distinct from national, challenges, such as worldwide economic stagnation, environmental degradation, civil war, and population growth" (p. 18). An educated population is a civilized one (Dale, 1982).

The case for education as development has tended to draw heavily from the human capital theory, which posits that an increase in the general level of education in a population should lead to greater labour productivity. Moock et al (1997) argue that, "education is an important determinant of earnings in market economies. The higher one's level of education is, the higher is that person's starting salary and the steeper the rise in earnings during the early working life" (p. 2). Szirmai (2005) argues that this has an impact beyond the individual. Not only would these individuals benefit from being able to demand higher salaries, but the country as a whole would also benefit from an increase in the supply of better-educated, higher skilled workers. The benefits that these external effects might bring about include, "more rapid technological change, reduced fertility and higher infant health" (p. 215). Durston and Nashire (2001) argue a similar point, suggesting that, "education raises the productivity of the poor's major asset, their labour, and results in higher income. The educated poor are more likely to adopt new technologies, hence get a higher return on their land, and to link into a wider range of self-employment opportunities" (p. 76).

Human capital theory provides a framework for measuring the costs versus the benefits of education on households, both in the developed and developing world. These costs could include school fees, the cost of books, transportation to and from the place of education. Further costs could also include the income a household loses whilst one of their members is receiving education. The individual in the education system delays their entry into the labour market for however many years it takes them to complete their education. During this time they are not earning and are therefore forgoing an income. However, the benefits of education can be seen to consist of, "the difference between the lifetime income of an individual with a given amount of education and the lifetime income he would receive if he had not had this education" (Szirmai, 2005: 216). Psacharopoulos and Patrinos (2004) observe that the return of investment in education in developing countries is far higher than the rate of return on investment in physical capital (i.e. infrastructure investment). They go on to argue that this return is more evident in primary education than it is in secondary and higher education.

While using aid to target education has obvious development benefits, there are also a number of potential pitfalls. Little (1999) suggests that there is an unequal power distribution present in most educational settings. She states that, "the educator generally conducts his/her negotiation from a position of power of the learner. The power resides in the status accorded the role of educator by the culture in which he/she educates and in his/her role in the process of educational assessment and selection" (p. 13). This unequal distribution of power can manifest itself in ways that can limit the role of education as a

development tool. For example, it can serve to widen the gender gap or gaps between different social groups that might exist in a society. In their role as educators, teachers reinforce these cultural norms. As Kabeer (1996) points out, "culture has profound material consequences, not only in shaping priorities and perceptions…but also in allocative behaviour and practices" (p. 16).

Dore (1983) suggests higher educational achievement leads of the inflation of qualifications. As education becomes more widely available it leads to a supply-led spiral, forcing individuals to take jobs at a level below what they could have expected to in the past. Employers have the luxury of being able to employ individuals who are overly qualified for the jobs they are offering due to the over supply of skilled workers in the labour market. The real effects of this compound as they pass down the educational food chain. Dore (1983) argues that this is what happens when too much focus is placed on education as a development tool and inevitably it is the poorest of the poor, typically the least educated, who ultimately pay the price for this.

## 5. Conclusions

This paper has presented a number of threats and opportunities that aid poses for development. The logic of aid is that it is supposed to provide temporary assistance in order to encourage the development of long-term behaviours such as revenue collection, investment in physical and human capital and the establishments of strong civil and state institutions. Once this has happened, the recipient nation can be weaned off aid.

However, this does not seem to happen in most cases. Proponents of aid hold up a few success stories, such as Botswana and South Korea, but it would be fair to argue that aid has failed to deliver on its promises. Aid breeds dependency and provides little incentive for the development of proper revenue collection systems, investment in physical or human capital or the creation and improvements of institutions. Why would you go to the bother of doing this if you knew that your supply of aid was unlikely to be cut off even if you didn't?

This paper would argue for a more realistic view of aid as an instrument for development. We arguably place too much faith in its abilities, hoping that if we give more it will eventually yield results. When it is carefully targeted and monitored, it can be effective. However, the results are rarely scalable. Aid is not going to provide the magic bullet to bridge the gap between rich and poor. This paper would agree with Easterly (2003) when he suggests that the goal of aid should be, "to benefit some poor people some of the time" (p. 40). This is all that can be expected of aid, as this is all that it can realistically deliver.

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