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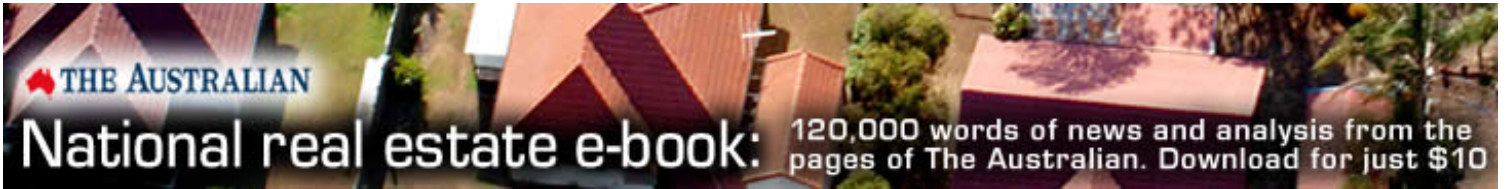
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Aid is not the answer to poverty

August 04, 2005

WE'RE rich because they're poor. No proposition is more central to the left-wing view of the world than the idea that the rich West survives in its comfort because it exploits the poor in the Third World.

A variation on this lies at the heart even of much Islamist terrorist ideology. The utterly ridiculous Peter Singer even wrote a book purporting to work out how many dollars the rich world should pay to the poor to make it rich too.

This thinking informs even Tony Blair's G8 aid initiative for Africa and all the maundering self-promotion of Bob Geldof and his claue. In reality little of the economies of the West interact with the poor world, and thus little of the West's wealth can possibly come from the poor.

Moreover, the moral imperative to most aid is also based on fantasy (of course emergency aid to save lives is always justified). A new study by the International Monetary Fund finds that there is no correlation between aid and economic growth.

The president of the Asia Development Bank, Haruhiko Kuroda, who is visiting Australia, told me yesterday that a large aid inflow can cause currency appreciation which renders a developing economy uncompetitive and therefore retards economic growth. And the only way poverty ever declines is through economic growth.

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Kuroda supports aid, but only if it is used effectively. He is taking the ADB ever deeper into technical assistance and policy dialogue with aid recipient countries, while maintaining the bank's main role as a lender for infrastructure.

The most fascinating recent piece of work on all this is a long survey article by Nancy Birdsall of the Centre for Global Development in Washington, and two collaborators, in the latest issue of Foreign Affairs. It is a hard-headed look at what works and what doesn't work in fighting poverty.

Its withering treatment of aid might be seen as giving comfort to the Right, in the sense that it promotes the idea that big government solutions just don't work. However, it is equally blunt in puncturing the Right's alternative myth, which is that free market economics work in promoting growth in poor countries. Free market economics in their way are just as useless as aid.

Birdsall makes the truly fascinating, convincing and entirely unfashionable case that different strokes work for different folks. It has long been a central contention of this column that theory in foreign affairs is almost entirely useless. Labels such as neo-conservative, realist, liberal idealist etc have very little analytical or even descriptive value. I'm now coming to the conclusion that theory doesn't have much utility in international economics either.

Birdsall takes an approach of enlightened empiricism. Compare Nicaragua and Vietnam, she suggests. Nicaragua gets a lot of aid, is a democracy, and has preferential access to the US market. Its economy is a basket case. Vietnam is a communist dictatorship and it has not even properly secured a system of property rights. It is anything but transparent. Yet Vietnam has reduced poverty significantly and grown at five per cent a year since 1988, which is extremely good for such a poor country and beyond the dreams of most African nations.

Kuroda points out that while the G8 focused on Africa, and he has no problem with that, there are 700 million people in Asia -- more than Africa's entire population -- living in poverty on less than \$US1 (\$1.30) a day. But Asia has also seen the most dramatic declines in poverty and boasts all the outstanding success stories of development.

The most telling aspect of this success is that it all follows different models. There is no one path to development, different cultures and societies develop in different ways.

Birdsall examines the most successful developing nations and discovers that none of the success stories has really followed orthodox economic advice, nor did they get much aid. Birdsall writes: "Would China have been better off implementing a

garden-variety World Bank structural adjustment program in 1978 instead of its own brand of heterodox gradualism? Almost all successful cases of development in the past 50 years have been based on creative -- and often heterodox -- policy innovations. South Korea and Taiwan, for example, combined their outward trade orientations with unorthodox policies: export subsidies, directed credit, patent and copyright infringements, domestic-content requirements on local production, high levels of tariff and non-tariff barriers, public ownership of large segments of banking and industry, and restrictions on capital flows, including direct foreign investment."

Similarly, India's stunning recent success looks nothing like East Asia's. It is based on different policies for a different culture. Birdsall suggests the key question is effective institutions, and opportunities for local business. If you don't have that, both aid and the free market are useless: "During the 1990s countries in sub-Saharan Africa received funding amounting on average to about 12 per cent of their GDP, while their average growth per capita declined by 0.6 per cent."

In fact, there are many, many ways that aid can damage a developing economy. But even external free market actions don't help much. We Australians like to feel virtuous by arguing for liberalisation in agriculture trade because it would not only help us but also poor countries. But Birdsall argues the net effect on poverty would be minor. Many poor countries are net importers of food and would be hit by price rises.

My take-out is that knowledge of an individual culture, an individual country's history and circumstances, and indeed of the key individuals within its leadership, is far more important than any general model, from the Left or the Right.

Overcoming poverty is up to poor countries themselves, an idea unwelcome to ideologues, theorists and most academics (except that tiny number still left in country studies) everywhere.

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