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How, not how much, the key to foreign aid

By Matt Wade

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After wallowing in the doldrums since the end of the Cold War, foreign aid has had a stunning revival in 2005.

The renaissance started with the devastating Indian Ocean earthquake and tsunami on Boxing Day 2004. This event touched Australians so deeply that donations are still trickling in to help the victims. Tsunami giving to Australian aid agencies has reached \$330 million, about 85 per cent of all overseas aid donations in 2003. The Federal Government, emboldened by the community's response, followed up with its biggest ever aid package - \$1 billion in grants and soft loans over five years to help Indonesia recover after the disaster.

The global outpouring for tsunami victims set the scene for a series of events that have put foreign aid firmly back in the spotlight.

The World Economic Forum in Davos, Switzerland, in late January, which brought together some of the world's most powerful business and political leaders, was dominated by the issue of poverty. At that meeting, international leaders - including our own prime minister, John Howard - fell over themselves to talk about how important it was to help the needy.

The British Prime Minister, Tony Blair, kept the aid bandwagon rolling with the release of the British Government's Africa Commission report in March, which called for a massive increase in aid to the world's poorest continent.

Last month finance ministers from the world's eight richest nations promised to forgive 100 per cent of the debt owed by some of the world's poorest countries. The offer will cancel both government-to-government debt and debts owed to the World Bank and the International Monetary Fund. The offer is contingent on beneficiaries agreeing to economic reforms including "the elimination of impediments to private investment, both domestic and foreign".

A leading American aid expert, Steve Radelet, said the G8's plan "means that the 25-year-old debt problem is now finally behind us for the 18 countries that immediately qualify, and perhaps as many as 20 others that could qualify over time". The 18 countries that immediately qualify will save a total of more than \$1 billion in debt service costs each year, on average, for the next 10 years.

Aid will again take centre stage over the next few days as the G8 leaders meet at Gleneagles in Scotland. Blair wants to convince his G8 counterparts to come up with a

big boost in aid to arrest the economic decline of Africa - the only continent where poverty is on the rise.

The foreign aid focus won't stop there. Two other events this year will keep the issue on the international agenda. In September the UN General Assembly will meet in New York to consider progress in meeting the Millennium Development Goals - an international initiative to halve the number of people living in abject poverty by 2015. In December Hong Kong will host a World Trade Organisation ministerial conference that will try to reinvigorate the Doha round of talks, which aims to benefit poor countries by reforming agricultural trade rules.

So what would it take to eradicate the world's worst poverty?

The first ingredient is a lot more money. The rough estimate of the World Bank and the British Treasury is that rich countries will have to find an extra \$50 billion in aid to achieve the Millennium Development Goals. Aid donors now give about \$60 billion a year in aid (Australia's contribution will be about \$2.5 billion of that in 2005-06), so that means halving abject poverty will require aid to be almost doubled.

But lifting aid spending is only part of the solution. Many of the studies assessing the resources needed for the achievement of the Millennium Development Goals stress that the level of financial assistance is just one factor in reducing poverty. There is universal recognition that economic policy and governance in poor countries need to be improved. Also, the impact of a big boost in aid will be limited if the boost is not accompanied by meaningful trade reform to give poor nations better access to markets in rich countries.

So what do economists make of these grand aid plans? It probably goes without saying that opinion is divided. There are optimists, like the globetrotting economic adviser Jeffrey Sachs, who are convinced a big increase in aid can be effectively deployed to end extreme poverty. But there are plenty of sceptics who say most poor-country Governments are not equipped to absorb a big increase in aid. They warn that extra aid money will be squandered and do more harm than good.

Veteran development economist and Columbia University professor Jagdish Bhagwati is also concerned about the capacity of weak African states to handle a big influx of aid. But rather than write off the aid effort, he has proposed an alternative. Bhagwati believes donors need to expand the notion of aid to including spending for the poor, not just in poor countries. He prefers the term "development assistance" to foreign aid because it can encompass much more than just giving money to fragile governments in poor countries. This broad definition of aid could include funding drug companies to develop vaccines for diseases that kill the poor, such as malaria. "Just as the British established the Institute for Tropical Medicine, the same approach could absorb far more substantial public monies today to win the war on disease in Africa," he wrote recently in the OECD Observer.

Aid for the poor could be used to reduce trade barriers that hurt poor farmers by compensating rich-world farmers who are heavily protected by subsidies. This could help open markets in rich countries to African exporters.

Bhagwati even proposes a "grey peace corps" - deploying skilled retirees in developing countries to train and mentor local workers.

"The possibilities are limitless," he says.

Reconceptualising aid in this way could encourage many donor countries to achieve and even surpass the UN goal of allocating 0.7 per cent of national income to aid. (Australia's contribution is just 0.28 per cent.)

The debate about foreign aid sometimes presents rich countries with a kind of Hobson's choice: lift aid and see much (or even all) of it wasted, or leave the poor to fend for themselves in the hope that things might get better in the future.

Bhagwati's proposals show that there are other options.