Why 'Beyond Aid' Matters

Memorandum for the International Development Committee

Owen Barder & Theodore Talbot, the Center for Global Development

This written evidence is submitted by the Center for Global Development (CGD), an independent, non-partisan think tank with offices in Washington, DC and London, UK. It conducts research and analysis on a wide range of topics related to how policies and actions of the rich and powerful affect poor people in the developing world. Examples include aid effectiveness, climate change, education, globalization, health, migration and trade. CGD works closely with thought leaders, policymakers, and others to move ideas to action. CGD Europe is a UK registered charity. For more information and fully transparent disclosure of CGD's sources of funding (including from the UK's Department for International Development), please see http://www.cgdev.org/page/about-cgd.

Summary

1. This memorandum sets out why policymakers should pay more attention to "beyond aid" policies for development. There are three reasons:

    a. The benefits to poor people that can be brought about by even quite modest 'beyond aid' policy changes are much larger than can be brought about through aid.

    b. 'Beyond aid' policies mainly address the underlying causes of poverty, while aid is most likely to be spent well when it addresses the symptoms of poverty and meets immediate humanitarian needs.

    c. As well as being beneficial for development, most of these 'beyond aid' policies would be good for the UK in the short run as well as in the long run. Aid, in contrast, costs the average British household about £430 a year: so the long run benefits come at a substantial short-term cost.

2. This should not be misconstrued as an argument for "trade not aid". Aid can be an effective instrument for improving the lives of poor people, and may also accelerate economic and social development. We applaud the British government's decision to increase foreign aid to 0.7% of national income.

3. There is no trade off between a large and effective aid programme and the pursuit of better 'beyond aid' policies. Policy-makers should support "trade *and* aid". Indeed, maximising the development impact of non-aid policies will enable the UK to spend foreign aid more effectively by focusing on where it is most likely to do the most good.

4. Examples of 'beyond aid' policies on which greater effort should be made include:

a) **Reducing trade barriers** that limit exports from poor countries: implementing aspects of the Doha Round negotiation could create real income gains for low- and lower middle-income countries of more than £28 billion a year.
b) Facilitating **private investment, especially for infrastructure**: lack of infrastructure financing for African countries may be reducing growth in some countries by as much as 2% a year.
c) Protecting **global environmental public goods**, which create substantial value for poor countries (fisheries alone contribute an estimated £17 billion a year to African economies), and the burden of whose depletion falls disproportionately on low-income countries.
d) Facilitating more **research and development and technology transfer**, ranging from new or cheaper pharmaceutical products to intellectual property that can be used by firms in poor countries.
e) Increasing the proportion of **migration that comes from developing countries**: even temporary migration of poor workers to rich countries creates massive annual income gains far larger than any aid programme.
f) Promoting **security**. While civil wars have a human cost and set back economic growth, the UK spends exports £12 billion worth of military and dual-use equipment to states on the Foreign and Commonwealth Office's list of Countries of Concern for human rights abuses.

5. The remainder of this memorandum is organised according to the categories of the Commitment to Development Index: (a) trade, (b) finance, (c) migration, (d) technology transfer, (e) environment, and (f) security. A memorandum about the Commitment to Development Index, and the UK's performance in it, is being submitted separately.

A. Trade

- *Real incomes of low- and middle-income countries would increase by an estimated £28.5 billion a year if the Doha Round commitments to lower tariffs were implemented. (These are net income gains, not transfers from elsewhere).*
- *The African Growth and Opportunities Act (AGOA) created £299 million per year in additional exports from infrastructure- and credit-constrained countries, demonstrating that even modest, unilateral concessions can result in increased trade and investment in poor countries.*
- *Increased access to jobs and investment would have substantial knock-on development impacts.*

6. Increasing market access for producers in poor countries increases the returns to starting a business, so liberalisation for exports from poor countries delivers dramatic economic and development impact. Developing countries are insufficiently well integrated into world trade, accounting for just over 2% of world trade in goods in 2009 (WTO, 2010).

7. Laborde et al. (2013) study the possible impact of the on-going WTO Doha Round negotiations and find real income gains to low- and lower middle- income countries of between £28.5 billion to £37.6 billion a year just from lower tariff barriers in rich countries. (Gains to rich countries from a trade deal are even larger – this is an example of policies that benefit both developed and developing countries.)

8. One way to see the benefits of trade is to consider the impact of an existing, limited preferential trade deal. Congress signed the African Growth and Opportunity Act (AGOA) into law in May 2000. Frazer and van Biesebroeck find a resulting increase in exports from eligible African countries of around £299 million a year. This suggests that market access can produce increases in income despite the other constraints on trade such as lack of access to credit, infrastructure and human capital.

9. Access to export markets has dramatic and positive consequences beyond enabling trade growth. Heath and Mobarak (2014), for example, study the garment export sector in Bangladesh enabled through trade deals like the EU Everything But Arms (EBA). They conclude that access to employment in factories increased school enrolment rates for girls and decreased average family sizes. The effects of the growth of the garment industry on educational attainment by girls and women were bigger than the effects of conditional cash transfers.

B. Finance

- *Underinvestment in power and transport infrastructure cost African firms an estimated 12% of sales and reduce growth rates of the worst-affected countries by up to 2% a year.*
- *More, better investment is needed to meet immediate infrastructure deficits estimated at £27 billion a year in Africa and a cumulative £1.4 trillion in Asia over the next decade.*
- *One part of the answer is tackling illicit financial flows: requiring company ownership information to be made available is estimated to enable better collection of £31 billion a year on average over the next fifteen years (in net present value terms) in additional taxes globally.*

10. Private sector development (PSD) remains a vexing challenge for traditional foreign aid. Cross-country data show that a robust private sector raises average incomes, fuels growth, and provides jobs, but aid agencies have struggled to invest effectively to support PSD in low-income countries.

11. Analysis by the Center for Global Development (Ramachandran et al., 2009) of survey data from 41,005 firms from 119 developing economies (41 of which are in Sub-Saharan Africa) suggests that these countries face common, consistent barriers to increasing firm size and productivity. Lack of a reliable electricity supply is the key constraint, especially for sub-Saharan Africa. Data from 2007 shows that *twenty-five* of the forty-four countries in sub-Saharan Africa were experiencing crippling power shortages (Wines, 2007). Power cuts reduce annual growth rates of the worst hit African economies by over 2% (World Bank, 2009).

12. Transport is also a serious problem. Limited availability and high cost of physical infrastructure in sub-Saharan Africa makes the private sector significantly less competitive. Firms to supply only fragmented regional markets or restrict themselves to the few sectors in which profits are high enough to cover transport costs.

13. The costs of underinvestment are large: the annual funding shortfall for low- and lower middle-income African countries is estimated at nearly £27 billion *per year* to overcome the current infrastructure gap within a 10-year period. For developing South Asia, Andrés et al. (2013) estimate a £1.4 trillion dollar infrastructure gap over the next decade.

14. Funding from institutions like the World Bank will not be enough. For example, a World Bank financing for electricity expanded from £151.8 million in 2002 to £0.6 billion in 2007, while total private investment into African roads grew from £0.9 billion between 1990 and 1999 to more than £12.8 billion between 2000 and 2005 (Ncube, 2013).

15. UK funding for multilateral investment banks generally- and the British development investment bank, CDC, in particular- could be greatly expanded. As of last year, CDC's portfolio totalled £2.31 billion, compared to the £27.8 billion portfolio of the IFC, the World Bank's private finance arm.

16. Tackling **illicit financial flows** (IFFs) could help governments in poor countries meet more of their own needs. These flows include tax evasion (like firms underreporting export values to lower their tax bills), theft of public assets and related corruption, the laundering of the proceeds of crime (like drug sales), and a range of market and regulatory abuses under cover of anonymity (like hidden connections between politicians regulating an industry and the industry itself).

17. Illicit flows, by their nature, are difficult to measure, but all studies put total costs in the billions annually. According to one estimate, twenty Sub-Saharan African lost an estimated 10% or more of their cumulative GDP produced between 1980 and 2009 to these outflows (GFI, 2013). The effect of mispricing of international trade for all developing countries has been separately estimated to be as much as £97.2 billion (Christian Aid, 2008), and equivalent to 3.4% of total government revenues in sub-Saharan Africa based on 2002-2006 data (Hollingshead, 2010).

18. Tackling illicit financial flows could increase government revenues and GDP substantially. Cobham (2014) proposes that rich countries can contribute by: eliminating the number of legal entities for which beneficial ownership information is not available (potential gains to global governmental taxable income over the next fifteen years on the order of £31 billion on average per year in present value terms), increasing automatic tax exchange to cover all trade and investment flows (£11 billion or more), and requiring companies to report publicly in all their countries of operation (benefits likely to be in the billions). Forecasting the increases in tax revenues from tackling IFFs is inherently imprecise, but consensus amongst researchers is that the possible scale of gains in tax revenues for least developed countries will be billions of dollars a year.

C. Migration

- *Even temporary migration dramatically raises poor people's incomes.*
- *A Cambodian worker would see a nine-fold increase in her monthly wage, just from working in the US.*
- *Making it easier for productive people to participate- even temporarily- in the UK labour force will raise overall living standards for people from developing countries.*

19. About 60% of global income inequality can be explained simply by which country people live in: one of the most effective ways to raise incomes of poor people would be to allow more people to choose what country to work or reside in (even temporarily).

20. Research on the US labour market by the Center for Global Development (CGD) shows that workers from Paraguay or Turkey, for example, could triple their monthly wages, while workers from poorer countries like Cambodia or Ghana could earn nine times more purely by working in the United States (Clemens, 2009). By contrast, there is no aid-funded project that would raise a workers income from £60 to £540 per month. Furthermore, migration, unlike aid, directly adds value to rich countries' economies.

21. There is little political appetite in the UK for an overall increase in immigration. Within that constraint, there are many possible ways to increase the proportion of migrants that come from developing countries, to help migrants to secure a greater share of the economic benefits of migration and prevent exploitation, help developing countries to benefit more from outward migration, and streamline administration and costs of existing visa schemes to improve UK firms' access to scarce, skilled, and internationally mobile workers.

22. Immigration is not a net cost to UK taxpayer. The OECD secretariat finds that migrants in the UK created a fiscal benefit of 0.5% of GDP last year, corroborating previous studies that show that between 2001 and 2011, immigrants from the EEA added £22.1 billion to the public finances, while non-EEA immigrants' net fiscal contribution was £2.9 billion (OECD, 2013).

23. Because immigrants are complements to—not substitutes for—existing workers, immigration increases growth but does not reduce the number of jobs available for native workers. Studies based on UK data show either no effect of immigration on current workers' wages: estimates range from a gain of £22 to a loss £2 a year for the lowest wage workers (Migration Advisory Committee, 2012). Ultimately, immigration increases the size of the economic pie by allocating talent to higher productivity jobs.

D. Environment

- *Least-developed countries gain substantial value from sustainable access to public goods like fisheries and forests (and are harder hit from extreme climate events due to human-caused climate change).*
- *Two examples are the African fisheries sector (which creates over £17 billion annually) and Indonesian forests (the clearing of which is a major driver of human-caused climate change).*
- *The UK could work within the multilateral system to protect these goods by minimising distortionary policies that subsidise overfishing and land clearing overseas.*

24. Fisheries play a vital role in providing food security and livelihoods to millions of people in poor countries. The fisheries sector of African countries was worth more than £10.6 billion in 2011, equivalent to over 6% of African agricultural GDP (De Graaf and Garibaldi, 2014), and *net* fisheries exports from all developing countries reached £21.4 billion in 2012 (FAO, 2014).

25. However, two thirds of the North Atlantic fish stocks and 82% of Mediterranean stocks are overfished. Fisheries can be a renewable resource only if they are carefully managed. High-income countries are the cause of this overfishing.

26. Despite the catastrophic risks to fish stocks of overfishing, the EU continues to subsidise engine replacement for vessels larger than 24 meters while half of the EU's distant-water fleet makes its own arrangement with third countries. Weak government capacity in developing countries increases the chance of fishing past sustainable yields (Keijzer, 2010).

27. More broadly, European agricultural policies have perverse effects in poor countries. For example, after the European Union adopted its biofuel directive in 2003, EU consumption of palm oil more than doubled. Increased EU demand for oilseeds to put into fuel tanks raised the price of palm and other commodities and increased the pressures to expand production into tropical forest areas (Elliott, 2014).

28. Indonesia has the fastest rate of deforestation in the world, making it one of the top emitters of greenhouse gas emitters in the world (Margono et al., 2012), and new palm oil plantations are a key cause of those trends (Persson et al., 2014).

29. The costs of failure to protect global environmental goods fall disproportionately on low- and lower middle-income countries. Climate change is the most obvious example: Mendelsohn et al. (2006) compare the costs to rich and poor countries from a warming climate and show the majority of the burden falls on the latter (because their higher average temperatures make them more vulnerable to predicted temperature increases).

E. Security

- *The main cost of conflict is human, but civil wars can reduce GDP growth by more than 2% a year.*
- *Last year the UK granted over 3,000 licenses worth more than £12 billion for exports of military and dual-use (civilian and military) equipment to countries of human rights concern, including Iran, Belarus, and Zimbabwe.*
- *The UK could contribute substantially more to UN peacekeeping operations and to security on the high seas.*

30. Conflict and insecurity have appalling human costs. In addition they also have longer-run effects on economic growth by destroying productive capital and reducing the incentives for firms and households to invest.

31. Collier (1999) estimates that countries in civil war experience a decline in growth of 2.2 percentage points, and other estimates are significantly higher. Arunatilake et al. (2001), for example, estimate that the discounted present value of Sri Lanka's civil war had to that point already cost up to 205% of its 1996 GDP.

32. The UK requires an approved export permit for arms sales or exports of technologies, like cryptographic equipment, that have a dual civilian and military use. Despite this safeguard, a report by the Committees on Arms Export Controls (2013) found 3,375 arms export licenses worth nearly £12 billion to countries on the Foreign and Commonwealth Office's (FCO) list of countries of human rights concern, including Iran, Russia, Sri, Lanka, Belarus and Zimbabwe. In the same period, the government rejected 148 applications (1% of approvals).

33. There is evidence that spending by these governments on arms reduces their investment in other areas (Galvin, 2003).

34. Peacekeeping missions are a cost-effective contribution to promoting stability overseas. The UK currently deploys personnel to three missions (in Cyprus, the Democratic Republic of Congo and South Sudan) of the sixteen currently deployed.

F. Technology transfer

- *Diffusion of knowledge has been among the most striking successful forms of development cooperation – including the Green Revolution, the eradication of smallpox, the spread of childhood vaccination, and "technologies" such as hand washing, oral rehydration therapy, the education of girls, road safety standards, or reducing open defecation (Kenny, 2012).*
- *FDI is an important mechanism for transfer of industrial know-how; but excessive protection of Intellectual Property Rights (IPRs) through, for example, restrictive trade agreements, inhibits it.*
- *The UK can lead on reducing copyright and IPR compliance burdens on poor countries, while continuing to support the development of global public goods like vaccine development through Advance Market Commitments (AMCs) or certification standards like ISO.*

35. The challenge for policymakers is to ensure that there are sufficient incentives for research and development, without sacrificing the possible benefits of that knowledge by restricting access to it through excessive intellectual property rights. Tighter controls on intellectual property- partially driven by commitments to IPRs poor countries have been required to make in free trade agreements- are part of the reason that developing countries have not been able to close the gap on industrialised countries.

36. Facilitating private investment is an important piece of this puzzle. Foreign firms that operate overseas increase the productivity of their suppliers and customers, train workers who can then migrate to other firms in the same sector with new skills, and demonstrate models that other firms can copy (Saggi, 2002).

37. Rich countries can also make the global pool of knowledge available to poor countries by targeted improvements in their intellectual property rights (IPR) regimes for developing countries.

38. The solution is not to advocate for no protection: Javorcik (2004) shows that foreign investors are less likely to produce in a foreign country if there are no laws on the books to protect their innovations. Instead, the UK can work at the multilateral level- particularly in the context of trade negotiations- to minimise copyright and patent terms *for developing countries*, so increasing the returns to "derivative innovations" without inhibiting investment.

39. Intellectual property rights protect innovations but future sales motivate them. Pharmaceutical companies, for example, do not invest in vaccines to treat diseases like malaria that disproportionately affect developing countries because they are unlikely to be able to sell a vaccine at a price high enough in these markets to recoup their research costs.

40. The Center for Global Development developed an Advance Market Commitment (AMC) for vaccines that motivates research spending by committing to pay for effective drugs to treat conditions that affect poor countries (Barder, 2005). The UK could develop AMC contracts for a range of other medicines, delivering a major global health public good in partnership with the private sector.

41. Rich countries can support increases in trade, investment and innovation by investing in international standards such as regulatory approval for medicines, or phytosanitary standards; consistent "weight and measures" like ISO certification are an example of this kind of public good and have been shown to increase inward investment (Clougherty, 2008).

References

Abadie, Alberto, and Javier Gardeazabal. "The economic costs of conflict: A case study of the Basque Country." American Economic Review (2003): 113-132.

African Development Bank (AfDB). Infrastructure Deficit and Opportunities in Africa. Economic Brief, September, 2010.

Andrés, Luis, Dan Biller, and Matías Herrera Dappe. Reducing Poverty by Closing South Asia's Infrastructure Gap. The World Bank. December 2013.

Arunatilake, Nisha, Sisira Jayasuriya, and Saman Kelegama. "The economic cost of the war in Sri Lanka." World Development 29.9 (2001): 1483-1500.

Barder, Owen, Albright, A., Kremer, M., & Levine, R. (2005). *Making Markets for Vaccines: From Ideas to Action*. Brookings Institutions Press.

Birdsall, Nancy. 2004. "New Issues in Development Assistance." Processed. Washington, DC: The Center for Global Development.

Borensztein, Eduardo, Jose De Gregorio, and Jong-Wha Lee. "How does foreign direct investment affect economic growth?." Journal of International Economics 45.1 (1998): 115-135.

Busch J. and Ferretti-Gallon K. 2014. "What Drives Deforestation and What Stops It? A Meta-Analysis of Spatially Explicit Econometric Studies" Working Paper No. 236. Washington, D.C.: Center for Global Development.

Carnahan, Michael, William Durch, and Scott Gilmore. "Economic impact of peacekeeping." Final Report for the UN DPKO Best Practices Section (PBPS). New York, NY (2006).

Carnahan, Michael, Scott Gilmore, and William Durch. "New data on the economic impact of UN peacekeeping." International Peacekeeping 14.3 (2007): 384-402.

Christian Aid, 2008, Death and Taxes: The true toll of tax dodging, Christian Aid: London.

Clemens, Michael A., Claudio E. Montenegro, and Lant Pritchett. "The place premium:

wage differences for identical workers across the US border." (2009).

Clougherty, Joseph A., and Michał Grajek. "The impact of ISO 9000 diffusion on trade and FDI: A new institutional analysis." Journal of International Business Studies 39.4 (2008): 613-633.

Cobham, Alex. "Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda." Copenhagen Consensus Center (2014).

Committees on Arms Export Controls. Scrutiny of Arms Exports and Arms Controls (2013).

De Graaf, G. & Garibaldi, L. 2014. The value of African fisheries. FAO Fisheries and Aquaculture Circular No. 1093. Rome, FAO.

Elliott, Kimberly Ann. 2014. "Biofuel Policies: Fuel versus Food, Forests, and Climate Change." Unpublished mimeograph. Washington, D.C.: Center for Global Development.

Fink, Carsten, and Keith E. Maskus, eds. Intellectual property and development: lessons from recent economic research. World Bank Publications, 2005.

Food and Agriculture Organisation (FAO). 2014. The State of the World Fisheries and Aquaculture 2014. FAO: Rome.

Galvin, Hannah. 2003. "The impact of defence spending on the economic growth of developing countries: A cross-section study." Defence and Peace Economics, 14:1, pp. 51-59.

Garth Frazer & Johannes Van Biesebroeck, 2010. "Trade Growth under the African Growth and Opportunity Act," The Review of Economics and Statistics, MIT Press, vol. 92(1), pages 128-144, February.

GFI, 2013, Illicit Financial Flows from Developing Countries: 2002-2011, Global Financial Integrity: Washington, DC.

Gibson, John, and David McKenzie. "The Development Impact of New Zealand's RSE Seasonal Worker Policy." World Bank (2010).

Heath, Rachel, and A. Mushfiq Mobarak. Manufacturing Growth and the Lives of Bangladeshi Women. No. w20383. National Bureau of Economic Research, 2014.

Hollingshead, A., 2010, The Implied Tax Revenue Loss from Trade Mispricing, Global Financial Integrity: Washington, DC.

Keijzer, N., "Fishing in trouble waters? An analysis of the upcoming reform of the Common Fisheries Polocy from the perspective of Policy Coherence for Development", ECDPM Discussion Paper 120, 2010.

Kenny, Charles. Mickey Mouse, Villain: How copyrights for U.S. cartoons are holding the developing world hostage. Foreign Policy. February 22, 2011.

Kenny, Charles. *Getting Better: why global development is succeeding--and how we can improve the* *world even more*. Basic Books, 2012.

Kimberly Elliott. 2013. "Subsidizing Farmers and Biofuels in Rich Countries: An Incoherent Agenda for Food Security." CGD Policy Paper 032. Washington DC: Center for Global Development.

Laborde, David, Will Martin and Dominique van der Mensbrugghe "Potential Real Income Effects of Doha Reforms" in Will Martin and Aaditya Mattoo, eds. Unfinished Business?: The WTO's Doha Agenda. International Bank for Reconstruction and Development/The World Bank, 2011.

Leo, Benjamin, Todd Moss, and Beth Schwanke. OPIC Unleashed: Strengthening US Tools to Promote Private-Sector Development Overseas. Center for Global Development, August, 2013.

Lindgren, Goran. "Measuring the Economic Costs of Internal Armed Conflict–A Review of Empirical Estimates." Uppsala University, Sweden. Paper for the conference Making Peace Work in Helsinki. 2004.

Margono, Belinda Arunarwati, et al. "Mapping and monitoring deforestation and forest degradation in Sumatra (Indonesia) using Landsat time series data sets from 1990 to 2010." *Environmental Research Letters* 7.3 (2012): 034010.

Mendelsohn, Robert, Ariel Dinar, and Larry Williams. "The distributional impact of climate change on rich and poor countries." Environment and Development Economics 11.02 (2006): 159-178.

Migration Advisory Committee. Analysis of the Impacts of Migration. Migration Advisory Committee, 2012.

Ncube, Mthuli. Financing Africa's infrastructure gap. The African Business Review. Setpember, 2013.

OECD (2013), International Migration Outlook 2013. Paris: OECD Publishing.

Oxfam. 2003. Guns Or Growth?: Assessing the Impact of Arms Sales on Sustainable Development.

Persson, U. Martin, Sabine Henders, and Christel Cederberg. "A method for calculating a land-use change carbon footprint (LUC-CFP) for agricultural commodities–applications to Brazilian beef and soy, Indonesian palm oil." Global change biology (2014).

Ramachandran, Vijaya, Alan H. Gelb, and Manju Kedia Shah. Africa's Private Sector: What's Wrong with the Business Environment and what to Do about it. CGD Books, 2009.

Saggi, Kamal. "Trade, foreign direct investment, and international technology transfer: A survey." The World Bank Research Observer 17.2 (2002): 191-235.

Schneider, Patricia Higino. "International trade, economic growth and intellectual property rights: A panel data study of developed and developing countries." Journal of Development Economics 78.2 (2005): 529-547.

Smarzynska Javorcik, Beata. "The composition of foreign direct investment and protection of intellectual property rights: Evidence from transition economies." European Economic Review 48.1 (2004): 39-62.

Wines, Michael. 2007. “Toiling in the Dark: Africa’s Power Crisis.” New York Times, July 29.

World Trade Organization Sub-Committee on Least-Developed Countries, Note by the Secretariat (WTO). “Market Access For Products And Services Of Export Interest To Least-Developed Countries.” WT/COMTD/LDC/W/48. 1 October 2010 (10-4993).