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The Case for Aid for the Poorest Countries

A paper prepared by HM Treasury and the Department for International Development, UK.

The Challenge

There is growing agreement that as we work together to fight terrorism, we must also work together to address the causes of poverty: not just because to do so is central to peace and security, but because to do so is right. This is a moral imperative, an economic necessity and a social duty.

Developed and developing countries have signed up to the Millennium Development Goals – including a halving of world poverty, every child in primary education, child mortality reduced by two-thirds. At present, over 1 billion people live on less than $1 a day, almost half of the world lives on less than $2 a day, over 110 million children do not go to school, and there are 7 million avoidable deaths each year from preventable diseases. These goals are a major challenge, and if we achieve them, a major step forward. We also need to remember that even if we achieve these goals, it would still only go part way to reducing global poverty. There might still remain up to a billion people in desperate poverty.

On current trends, **sub-Saharan Africa will fail to meet these 2015 goals**. In the past decade income poverty in sub-Saharan Africa has remained static, with just under half of the population living on less than $1 a day. Primary education enrolment fell during the 1990s in 17 countries, and is not improving rapidly enough to meet the goals. The health situation is stagnating, and the HIV pandemic, with adult prevalence rates in some countries as high as 35%, threatens all development progress. South Asia too, may only just meet the education goal, and **in many parts of the world, the goal of getting as many girls as boys into school by 2005 will be missed completely**.

Achieving the 2015 goals, particularly in Africa, is one of the greatest challenges we face at the start of the 21st century, and while we are making progress in many regions and in many countries, we will fail in Africa unless extraordinary efforts are made.

We have the capacity to change this. A great deal relies on the efforts of developing countries themselves. And we need to do more to open up to trade from the poorest countries, and to encourage larger investment flows to developing countries. **However, these goals will not be achieved unless we increase the volume of assistance going to developing countries, target assistance at the poorest countries, and do much more to increase its effectiveness.**

At the moment aid flows are around their lowest for a decade; in Africa, they fell from $32 per capita in 1990 to $19 per capita in 1998. ODA has fallen while at the same time there is concern over whether aid works or not, and whether poor country governments can ensure that aid is actually effective in assisting poverty reduction.

In order to address valid concerns, **we require a step change in current practice by both developing country governments, and donors.** This year, Financing for Development, the G8 Africa work, NEPAD, WSSD, all provide important opportunities to make progress.

Progress in fighting poverty

Development aid has at times been a spectacular success - Botswana and South Korea in the 1960s, Indonesia in the 1970s, Bolivia and Ghana in the late 1980s, and Uganda, Vietnam and Eastern Europe in the 1990s – delivering finance to support reform and growth; addressing poverty reduction, education and health; contributing ideas about development policy; and building the capacity of government institutions. South Korea, for instance, moved from being an aid recipient when it joined IDA in 1962, to become an IDA donor in 1978, within 17 years of joining.

Major progress has been made in fighting poverty in the past decades; income poverty across the globe has fallen faster in the past 50 years than in the previous 50 decades. Life expectancy has increased in developing countries by 10 years between the 1970s to the end of the 1990s. Child mortality fell by a third during this period. Since the 1960s, illiteracy has halved.

In sub-Saharan Africa, the foundations for improved progress are being created. The recent global downturn has impacted negatively on sub-Saharan Africa, but in many countries sounder macroeconomic policies have been helping to lower inflation, (which averaged 55% a year in the region in the early 1990s) to around 10% in 2001.

Structural reforms, supported by aid, continue to be pursued with determination in many countries, including Cameroon, Ethiopia, Mali, Mozambique, Rwanda, Tanzania, Senegal and Uganda.

HIPC provides evidence of further progress. Countries that are receiving debt relief under the HIPC Initiative continue to demonstrate their commitment to poverty reduction, are improving public expenditure management, and linking expenditures to poverty reduction efforts.

The **HIPC** Initiative is clearing away the major part of the debt burden accumulated by the poorest and most indebted countries: and so allowing aid to encourage growth, rather than merely offset the continuing effects of past economic mismanagement.

As an example of what can be achieved, **Uganda** has reduced extreme poverty by over 20% since 1992, down to 35% of the population. Growth has averaged around 7% over the past decade and industrial output has increased by 12% a year. Around half of Uganda's budget is financed through aid, a major investment that is helping Uganda effectively deliver. Uganda used HIPC debt relief and substantial aid, to help provide free primary education, where enrolment doubled to around 6m children. Between 1998 and 2001, 20,000 classrooms have been built, more than a 50% increase, and 30,000 primary school teachers have been recruited. The government recently went another step forward and introduced free basic health care. Uganda, along with Senegal, is one of the few African countries to have made significant progress in reducing HIV rates. Prevalence in urban areas has been reduced by a half, and nationally by a third.

In **Tanzania** aid is a major contribution to government expenditures, making up half of government expenditure in 2000/01. This has enabled increased social spending, where, for instance, recurrent education spending rose by 19%, and in health by 30% last year. Tanzania is using HIPC benefits, World Bank and donor aid, to help finance free primary education, a key priority in the nation's poverty reduction strategy. Net enrolment in primary schools increased from 57% in 1999 to 65% in 2001, and the transition rate from primary to secondary school increased from 15% to 19.5% in the same period. Per capita GDP growth has more than doubled between 1988 and 2001, with overall growth reaching almost 6%, and inflation has reduced from 13% in 1998 to 5%.

In **Mali**, a strong adjustment programme, with recent growth averaging around 5%, coupled with investments in health and education, has led to a reduction in poverty of over 7% in the past 4 years. In Mali, aid levels are around 14% of gross national income.

Ghana, with substantial donor support from 1983 recovered from a period of decline that, in the 1970s, saw per capita income reduce by an average of 3% per annum. The share of aid in government spending rose to over 50% during this period, and supported a programme of economic reform that saw growth average 5% between 1983-92, and 4.4% between 1992-98. Poverty fell from 51% of the population in 1991/92 to 43% in 1998/99.

Mozambique is another strong performer, recovering from a conflict that displaced 3 million people and destroyed much of the country's infrastructure. Growth over the past four years has been around 9%, and investor confidence growing as evidenced by a recent $800m investment in an aluminium smelter, which could help triple exports, and add 7% to GDP in the first 5 years. Aid flows since 1995 have been around 17% of GDP. These high volumes, combined with sound policies, have enabled Mozambique to stabilise and adjust while breaking the cycle of low savings and low growth. Over 3,000 primary schools have been rehabilitated, doubling the post-war numbers of schools. Infant mortality has decreased from 150/1,000 live births in 1990 to 134 in 1998.

Vietnam has halved poverty in the past 15 years, down to 37% of the population living below the poverty line; recent surveys note that even the numbers of 'food poor' - the very poorest - reduced by 10% between 1993 to 1998, down to 15%. Life expectancy is 70 years, child mortality has reduced by two thirds and primary education is almost universal. Market reforms have played a major role, and growth has been around 8% over the past decade. Vietnam is not aid dependent. Current levels, at around $1 billion a year, account for around 20% of government spending. However, aid plays a significant catalytic and developmental role, supporting more complex 'second generation' policy reforms in banking, trade and state owned enterprises; providing additional investment in infrastructure, and has helped provide stable flows through the East Asia financial crisis.

In **Bangladesh**, economic growth has reduced aid dependence from 85% of the development budget at the end of the 1980s, to less than half now, some 15% of total government expenditure. Aid has been invested in infrastructure, bridges and power, and communications, as well as supporting strong civil society organisations delivering education, health and micro-finance to poor people who may otherwise not have been reached. Since the 1970s, the fertility rate has declined by more than a half, child immunization has increased from 10% to 70%. Child mortality, with one in five children dying before their fifth birthday, more than halved between the 1980s and 1990s.

Aid has also played a vital role in making progress in social sector areas. In **education**, project support has helped train teachers and build schools. Long-term budget support has provided the resources necessary to provide universal primary education, while encouraging governments to raise their education sector financing, and aid has helped to improve efficiency and improve the quality of education systems and delivery. Enrolments in Malawi, Mauritania, and Uganda doubled in five years with the abolition of school fees, where Malawi saw an immediate 60% rise in 1994. Enrolment rates of over 90% have also been achieved in Botswana, Equatorial Guinea, Swaziland, South Africa and Zimbabwe. In South and West Asia, primary enrolment is approaching 75%. Progress in girls enrolment has also been made. In Guinea for instance, girls enrolment doubled between 1991 and 1998. In Bangladesh, the girl/boy ratio has improved from 40/60 to 49/51 in under twenty years.

Poor **health** is a major barrier to development progress. High malaria prevalence reduces growth in Africa by around 1%; HIV/AIDS prevalence of 20% can cut growth by 2½ percent. Conversely, healthier societies earn more. Recent studies found that a 10% increase in life expectancy is associated with a 0.3% increase in annual growth. Aid helps to promote knowledge of good policies, and aid finance is vital for countries with under-resourced health systems.

In **China**, for instance, deaths from tuberculosis (TB) accounted for one in two deaths from infectious diseases. Government adopted the internationally developed Directly Observed Treatment Strategy (DOTS), with the assistance of a World Bank loan. Since then, TB deaths have been halved. A donor supported Polio programme in India helped reduce polio cases from 40,000 in 1994 to around 1,000 in 1999.

The role of development assistance in supporting **global public goods** is also important. Smallpox has been eradicated through WHO and donor support; the WHO Polio Eradication Initiative has led to a reduction in cases by more than 95% from its launch in 1988. Eradication of polio could save $1.5 billion annually in vaccination costs. Deaths in children from diarrhoeal diseases have been reduced from 4.6 million children in 1980 to 1.5 million in 1999. The World Bank estimates that 3 million child deaths are prevented each year thanks to immunisation.

Public-Private Partnerships are playing a key role in bringing private sector expertise and resources into areas that are not commercially viable. The Global Alliance for Vaccines and Immunisation has mobilised over 39 million additional dollars for strengthening ongoing services, and invested 84 million dollars in new vaccines for diseases responsible for nearly 1.5 million deaths in poor countries. New efforts through the Global Health Fund should help us move forward in the fight against HIV/AIDS and malaria.

Progress in **water supply and sanitation** has been supported by aid, where around 20% of the $30 billion spent a year in the water sector is provided through aid flows, with the domestic public sector providing 70%, and international private investment and household/communities providing the rest. A joint WHO/UNICEF survey notes that between 1990 and 2000, approximately 816 million additional people benefited from clean water, and 747 million people from sanitation. By 1999, 69% of the rural and 91% of the urban populations of Africa, Asia and Latin America had access to water, and 30% rural and 80% urban to sanitation. India more than doubled access to water from 41% to 88% during this period. Uganda saw access to water increase from 17% to 52% in the last ten years. In Mozambique, the National Programme for Low Cost Sanitation has supplied almost 1 million people with access to improved latrines through small businesses manufacturing latrine slabs. Urban coverage has now reached 71%.

But aid has also been, at times, an unmitigated failure. As the World Bank itself has noted:

- in Zaire (now the Democratic Republic of Congo) a steady flow of aid ignored, if not encouraged, incompetence, corruption and misguided policies. This demonstrates the weakness of allocating aid for political rather than developmental reasons.
- in Zambia, high flows of aid have not improved stagnating incomes which in real terms are less than they were in the 1960s.

In recent years these lessons have been learned and there is now international agreement amongst progressive countries on how aid can be most effective in reducing poverty and building capacity in the poorest countries. **Overall, better use of aid by bilateral donors and international institutions could make aid up to 50% more effective in reducing poverty.**

Improving aid effectiveness - lessons from the past, building success in the future

Aid is seen as being effective through three routes. First, the **finance** itself is vital for countries with very low resources of their own, such as Uganda or Mozambique. Low-income countries' development would be very much slower if they had to rely on their own and private sector resources. The funding of infrastructure in Bangladesh or Vietnam facilitated communications and growth, at a time when the private sector was not prepared to invest sufficiently.

It is important that the aid flow itself is reliable. Long-term support provides governments with the ability to plan their spending. This can play a valuable role in response to shocks - particularly important now, with a 25% fall in agricultural commodity prices over the last three years. Aid generally is not delivered fast enough to be counter-cyclical and fill gaps – though HIPC debt relief is taking account of shortfalls. But a regular flow of aid finance increases security in the face of drought, hurricane, or commodity price falls.

Second, aid provides **ideas**. More specifically, it can help a country generate, grapple with and modify ideas to suit local circumstances – such as economic policy analysis in Bolivia, Ghana and Vietnam, or ways of tackling tuberculosis in China, Nepal and Peru. This is not a one-way transmission of ideas from external experts to developing countries. The Poverty Reduction Strategy Paper approach, for example, was in part born from the experience of Uganda's Poverty Eradication Action Plan.

It is sometimes argued that ideas are cheap, and indeed they can be: key economic discussions with Vietnam took place before substantial aid was delivered. But ideas need to be turned into policy that is implemented, and aid used to help implement these ideas.

Thirdly, aid can help to **ease the cost of adopting good policies.** It is generally agreed that donors have not been effective in "buying" policy through conditions on aid, where the government is opposed to the policy. But there are cases where government is basically in favour, but there are significant losses to particularly influential groups. For example, a switch of health funds from hospitals to clinics would hurt urban elites who need hospital care. In these circumstances, the availability of aid funds at the beginning can reduce the size of the impact and so defuse opposition.

Aid effectiveness is improving. Evaluations undertaken by the World Bank show that their project aid has improved in quality over recent years, from around 70% satisfactory (or better) rating in the 1980s, to almost 80% in 2000.

We have also learnt that aid has a positive impact on growth, particularly where governments are pursuing good policies. Recent World Bank[1] research observes that **1% of GDP in assistance can produce a 0.6% increase in growth in countries with good policies, a 1.2% decline in poverty and a similar decline in infant mortality. Growth increases by 0.3% in countries with average policies, and by 0.1% in countries with poor policies.** There is other evidence too that the impact of aid has increased since the 1980s[2], and recent research paints an even more positive picture that aid works, even in relatively poor policy environments, and highlights that past perceptions of the ineffectiveness of aid have been fanned by a few influential but flawed studies[3].

But aid also has wider benefits that go beyond the income enhancing effects of faster growth. Effective aid complements private investment, **'crowding in'**

1 Paul Collier and David Dollar, "Aid Allocation and Poverty Reduction", forthcoming in European Economic Review (2002).

2 Mosley, P. and Hudson, J. (2000), "Has aid effectiveness increased?", mimeo, July 2000, (circulated at DSA Annual Conference, SOAS 4 Nov 2000), University of Sheffield.

3 Hansen, H and Tarp, F. (2000), "Aid effectiveness disputed", *Journal of International Development*, Vol.12, pp.375-398.

private investment by a ratio of almost $2 to every $1 of aid, and so helping to build sustainable growth and development for the long term.

Improvements in economic institutions and policies in the developing world are key to reducing poverty. And when societies desire reform, foreign aid can provide critical support. An active civil society can also help change the way the public sector does business, improving public services.

Aid has also proven to be particularly effective in helping countries adjust to temporary shocks, by mitigating output losses and helping to maintain a good policy environment. Other recent studies suggest that in 1990, **$1 billion of aid raised some 105,000 people out of extreme poverty, permanently. In 1997, with better-distributed aid, $1 billion raised 284,000 people out of poverty, permanently.**

If all aid were concentrated where it can do the most good, it could raise the number of people lifted out of poverty by another 50%. In order to do so, financial assistance must be targeted more effectively to low-income countries with sound economic management, and where there are large numbers of poor people. In 1999, per capita aid was $23 in Europe and Central Asia, $18 in the Middle East and North Africa, compared with $9 for low-income countries as a whole. If all donors increased the proportion of their aid going to poor countries to three-quarters, this would **release $5-6bn additional finance** for poor countries. More needs to be done to shift allocations from 'political' priorities to 'development' priorities.

Aid effectiveness can be further increased by more untying. This process has started, with the recent OECD agreement to untie all financial aid to the Least Developed Countries. **Untying aid can increase the value for money achieved by between 10-20%**: although, as tied aid is only a fifth of the total, the overall impact is more modest.

Experience shows that development assistance works best when it supports a strategy designed and led by the national government in consultation with its civil society. That is why aid should support **poverty reduction strategy** principles. These principles recognise the importance of a nationally owned, comprehensive strategy for development. By providing aid which supports a country's poverty reduction strategy, with harmonised, long term commitments of support, donors can help to build capable and accountable states. Early evidence shows that countries implementing PRSPs have increased poverty reduction spending by 20%.

Governance, the key to unlocking increased aid and development progress

Without serious action by poor country governments to address valid governance concerns, there will be no breakthrough on building support for increased aid, and limited development progress. Public expenditure management concerns have rightly contributed to negative views about the effectiveness of aid. Progress in economic governance, and delivery on codes and standards, provides important signals not only to donors, but importantly to the private sector and the promotion of foreign and domestic investment. Within Africa, NEPAD is an important opportunity to make serious progress in this area

Countries themselves must be able to show that the public resources, and the funds they receive through aid and increased debt relief, are properly and effectively used. Progress is already being made in this area through IMF and World Bank support, through exercises to track HIPC debt relief finance, and build longer term capacity for improved public expenditure management. We know that HIPC has freed up $1.7bn this year for extra spending by HIPC governments, with 40% of this going into education and 25% into health; providing important boosts to government spending.

Fifteen countries in Africa have been undertaking IMF supported work on codes and standards; the recent HIPC tracking exercise has also been an opportunity for more countries to undertake Reports on Standards and Codes (ROSCs) on Fiscal Transparency. World Bank support to Country Financial Accountability Assessments (CFAA) and Public Expenditure Reviews are another important component of improving governance in these areas. External assistance has also helped to promote the role of civil society in demanding more accountable government, including in areas such as public expenditure management.

Increased aid flows - vital in order to achieve the MDGs

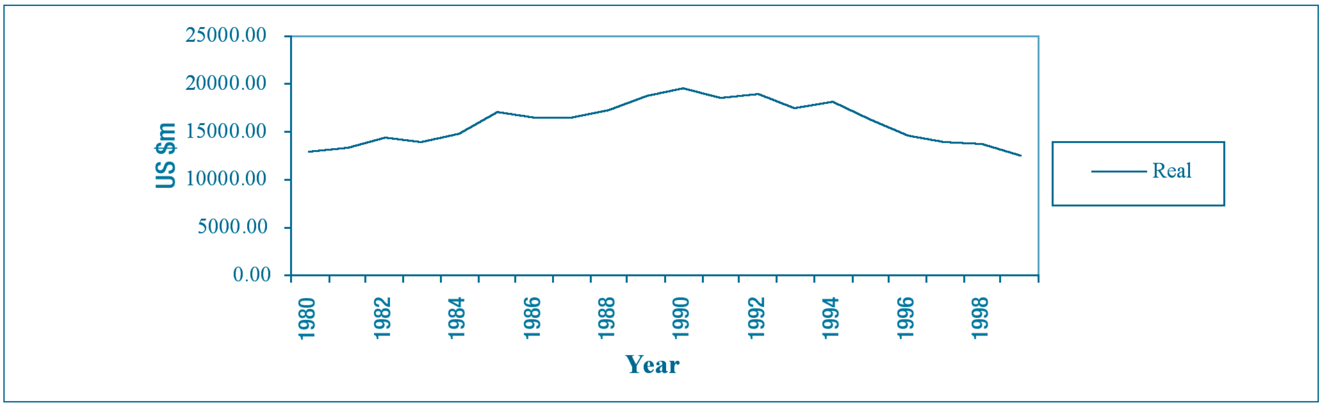
The Zedillo report prepared for the UN conference on Financing for Development argued that in addition to progress on making aid more effective, and on increased access to developed country markets, significant increases in the **volume of aid** will be necessary in order to achieve the MDGs. Zedillo argues that **an extra $50bn a year of aid will be required**, a doubling of current aid flows. It should be noted that this is a small amount of expenditure compared to other areas of government expenditure in OECD countries. For example, the OECD countries spend $1,268 billion of public resources on education alone, more than 25 times the amount needed for the MDGs to be achieved.

Further work by the World Bank[4] supports this estimate, putting the cost of the goals in the range of $40-60 billion. The World Bank estimates that the additional cost of achieving universal primary education is in the order of $10 to $15 billion annually, similar to the UNICEF estimate of $9.1 billion. They note too that the health goals will cost in the order an additional $20 to $25 billion annually, broadly similar to WHO estimates.

The World Bank also notes that although the benefits of increased market access for developing countries will provide greater financial benefits than current aid flows, for many countries the gains would be much less. Africa plays a small part in world trade for instance, and many low-income countries will be too poor to benefit from increased access without major investments in trade-creating infrastructure.

While progress has been made on aid effectiveness, aid to low-income countries elsewhere is shrinking, from $13 per capita in 1990, to $9 in 1999. Aid to Africa is currently around $13 billion pa and has declined steadily since 1990 (see Figure 1). A number of political and economic factors can explain this trend, but the main one is donor fatigue. Despite large aid inflows (largely offset, however, by terms of trade losses), African growth has been low. Growth is currently below 3%, less than is needed to keep per capita incomes from declining further.

Figure 1: All Donor Net ODA to Sub Saharan Africa



Source: DAC on-line database (uses DAC deflator)

4 World Bank, 2002, "The Costs of Attaining the Millennium Development Goals"

The challenge for the international community is to provide the additional $50 bn a year that is required. The EU countries have made a critical step forward in their commitment to increase the EU average aid levels to 0.39% of gross national income by 2006.

The UK government is doing its part, and has raised its level of aid to £3.6 billion, a 45% increase in real terms from 1997/98. The UK is committed to the target of raising development assistance to 0.7 percent of national income, and will significantly raise the amount of our development assistance, and its share in national income, in the next spending round. This will soon be announced, and will cover the years up to 2005/06. The UK has also untied all aid allocated after April 2001, and focuses its support on the poorest countries, with 80 percent of its bilateral aid going to low-income countries.

Making progress on the Millennium Development goals remains a major challenge. In the medium term, we expect a demonstrative effect where aid is provided to countries with credible programmes to reduce poverty and improve financial management and accountability, and which have developed a medium term action plan, with clear benchmarks to measure progress. Such countries should receive increased aid in order to accelerate progress towards poverty reduction goals. This approach could provide the incentive for wider progress across all low income countries, including across Africa through NEPAD. **No country which is genuinely committed to economic development, poverty reduction and good governance, should be denied that chance to achieve progress in health and education and the other Millennium Development Goals through lack of finance.**

Other innovative approaches to increasing development finance should also be explored. One such option is through SDR allocations.

But without a three-pronged strategy – improved trade access, increased aid effectiveness, and enhanced aid flows to support and promote policy reforms and improvements in governance – we will not meet the Millennium Development Goals. With these three elements in place, and progress on delivering this approach, the Goals will be achievable through improved partnership between developing and developed countries.

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