

Foreign Aid: A Fool's Errand?

Dr. Stephen Krasner

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Prior to WWI finance was tied to specific foreign policy objectives

- Germany
 - financed Ottoman Railways to get port access
 - stopped lending to Russia when alliance collapses
- France
 - Denies German access to French capital markets
 - Gives Russia access as alliance grows in the 1890s
- England
 - loans to Russia increase after Anglo-Russian treaty of 1907

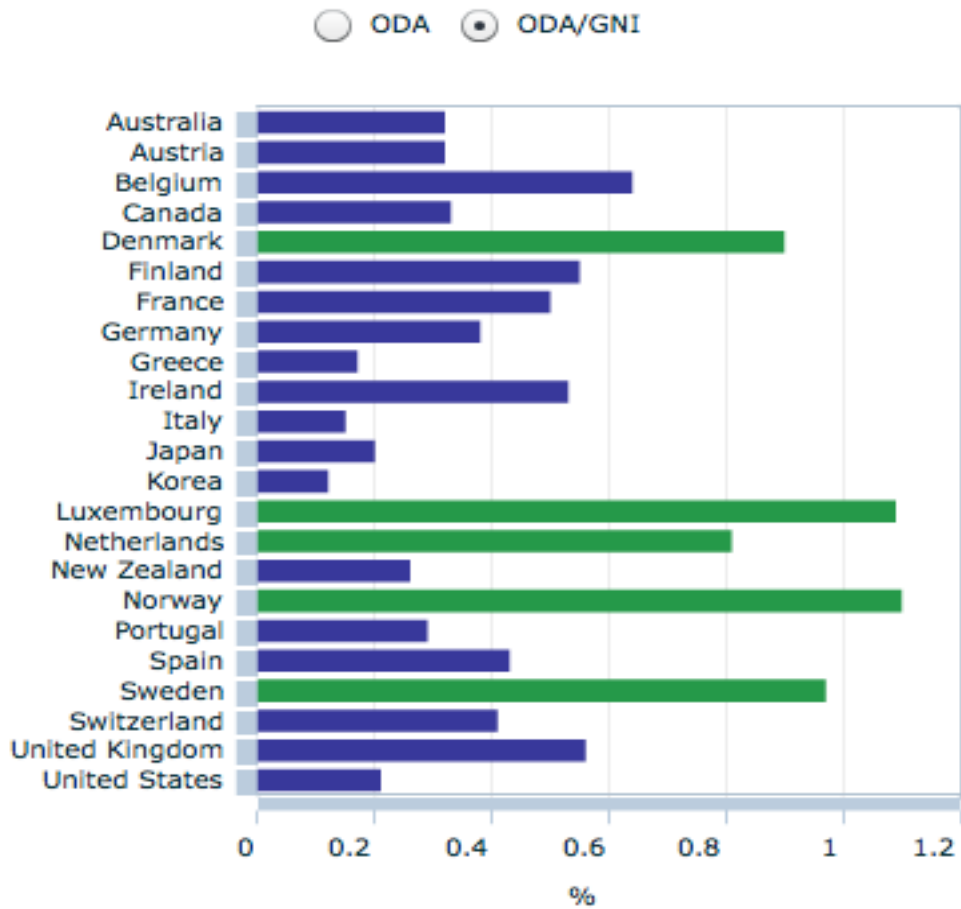
Foreign Assistance Begins After WWII

- Economic deprivation tied to international conflict
 - The Great Depression and Nazi Germany
 - Need to rebuild Europe
- Creation of the World Bank, IMF and other IFIs:
 - insulate some aid from the preferences of specific donors

Aid Commitments Mirror Domestic Attributes of Donors

- Aid as a percentage of GNP correlates strongly with social welfare expenditures as a percent of GNP
- Left leaning government give higher percentages of aid
- Small European social democratic countries are largest aid donors

ODA/GNI in 2010 - Total DAC = 0.32 %



No Sort Sort by ODA/GNI

■ These countries have met the UN ODA target of 0.7% of GNI.

Foreign Assistance Has Not Succeeded, At Least Not Very Well

- Very very few countries have graduated from foreign assistance, perhaps only Korea and Greece
- Africa has received \$568 billion over 42 years.
 - Per capita growth rate of median African country is near 0
- No correlations between adjustment assistance and growth
- Debt forgiveness has not been correlated with higher growth
- Recent statistical studies have found
 - Modest relationship between aid and growth (1 percent)
 - No relationship
 - A negative relationship

Foreign Aid Successes

- Health
 - Immunization: smallpox eradication
 - Greater Life Expectancy
 - AIDs treatment in Africa?
- Green Revolution

Why Foreign Aid Has Succeeded

Targeted

Simple stand alone tasks

Not dependent on national governance capacity

Why Foreign Assistance Has Failed: Donor Failures

- Lack of accountability for donors
 - Multiple donors
 - Outcomes cannot be associated with specific programs
- Weak Conditionality
 - donors always provide funds
- Donors are incapable of taking adequate account of local institutions and circumstances
 - E.g traditional communal property rights vs exclusive individual ownership

Why Foreign Aid Has Failed: Perverse Incentives

Substitutes for taxes

Encourages corruption

Weakens social trust

Why Foreign Aid Has Failed: Lack of Local Knowledge

Three Approaches to State Building

Modernization Theory

Institutional Capacity

Rational Choice Institutionalism

Modernization Theory

- Economic and social development leads to political development
- Economic development requires more capital
- Foreign assistance can provide more capital
- Implications for foreign assistance
 - Meet the 0.7 percent of GDP target
 - Provide more funds to meet the MDGs
 - Most types of foreign aid are consistent with modernization theory
 - Budget support
 - Infrastructure
 - Resources for social services
 - Debt forgiveness
 - Structural adjustment

Institutional Capacity

- Economic and social mobilization without greater institutional capacity → political decay (Egypt 2011?)
- Implication for foreign assistance
 - Build state capacity
 - Training
 - Technical Assistance

Rational Choice Institutionalism

- Political and economic outcomes reflect strategic choices made by key actors (usually elites)
- Implications for Foreign Assistance:
 - Change Incentives for Leaders
 - Millennium Challenge Account
 - Trade Agreements
 - Mo Ibrahim Prize
 - Support independent actors
 - Civil society, religious organizations, lawyers, even companies
 - Accept external control where Pareto improving deals are impossible
 - Shared sovereignty
 - Charter cities
 - Neo-trusteeships
 - Examples: RAMSI, GEMAP

Sachs, Easterly, Collier

- Sachs: Give more money (modernization)
- Easterly: Planners vs searchers (rational choice)
 - Planners fail; searchers sometimes succeed
 - Think small; think local
- Collier: External provision of security and accountability (rational choice)
 - No security; no development
 - Think big or at least ambitiously

Sachs is wrong

Collier is right but difficult

- Substitute for local governance

Easterly is right

- Think local
- Think small
- Offer incentives

Prescription for Korea

1. Continue Japan like pattern: aid leads investment
2. Identify some signature initiative:
 - Green innovation
 - Others?