Foreign Aid: A Fool’s Errand?

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Distinguished Speaker Series
The Asan Institute for Policy Studies
October 19, 2011
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 %

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?