

Planners vs. Searchers in Foreign Aid

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The Planners

- One recent publication has the solution to world poverty:
- a “Big Push” of carefully-planned aid-financed investment to end the “poverty trap” of the poor countries
- “Success in ending the poverty trap will be much easier than it appears.”
- Similar language and recommendations in UN Millennium Development Goals campaign to halve world poverty by 2015, G-8 Summit 2005, and Blair Commission for Africa (2005)
- This approach we will call “The Planners”

Evidence

- No evidence that poor countries are in the kind of “poverty trap” that requires a “Big Push” from foreign aid
- Poorest countries are no more likely than the rest to have zero per capita growth or to fall further behind the richest countries (Easterly 2006)
- Saving-income relationship does not behave in a way that would generate a poverty trap (Kraay and Raddatz 2005)
- No evidence that aid raises growth to escape the non-existent poverty trap

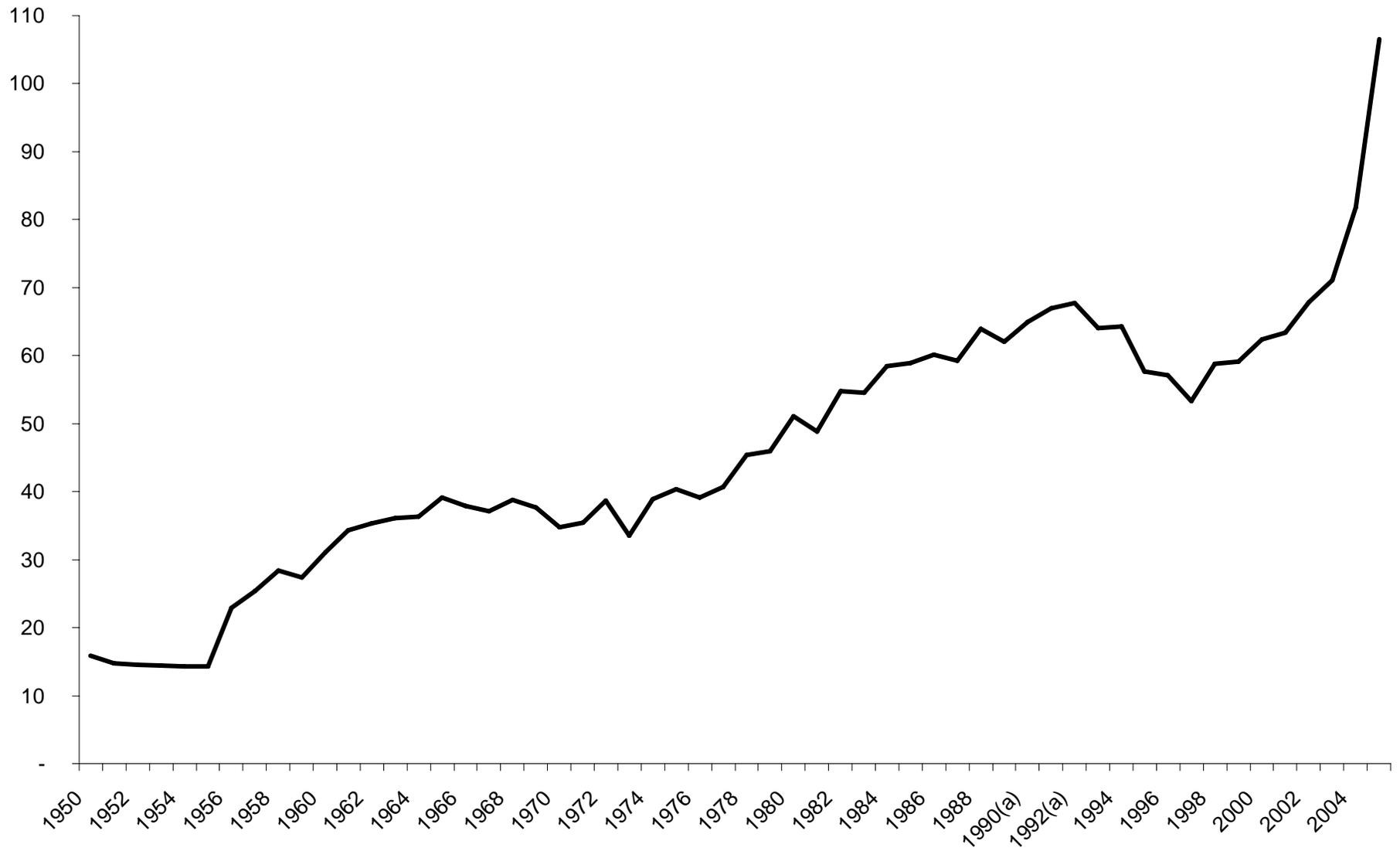
The First Law of Foreign Aid Analysis

- Whenever anyone recommends an increase in foreign aid...
- The recommended increase is exactly double.

Doubling aid created a couple of generations worth of Big Pushes

- JFK advisor Walt Rostow called for doubling foreign aid in 1960
- World Bank President McNamara called for doubling aid in 1973.
- WB called for doubling aid with end of Cold War in 1990.
- G-8 Summit in July 2005 agreed to double aid to Africa.
- China announced doubling of its aid to Africa in November 2006.
- George W. Bush is implementing an increase US aid of 50 percent.
- Obsession with **amount spent** substitutes for asking whether that money actually reaches the poor

Total foreign aid from OECD countries in 2005 US\$ billion, 1950-2005



The failure of the “Big Push”

- Quarter of countries with highest average aid over last 42 years (average 16 percent of GDP for 42 years)...
- ...Have 0.4 percent growth of income per head per year over last 42 years.
- \$568 billion in aid went to Africa, zero rise in living standards over the last 42 years.
- Of course, there are severe problems of adverse selection/reverse causality in disentangling relationship between aid and growth.
- However, much research on aid and growth addressing these econometric issues has failed to find any robust result that aid raises growth (e.g. Boone (1996), Burnside and Dollar (2000), Easterly, Levine, and Roodman 2003, Rajan and Subramanian 2005)

Planners' approach to end world poverty – a few incentive flaws...

- Collective responsibility of all donors and recipients for outcomes (free-rider problems)
- Multiple goals (such as 54 targets for 2015 for the Millennium Development Goals) for each agent – equivalent to multiple principals problem for the same agent.
- In the maze of collective responsibility for multiple goals, nobody is individually responsible for anything.

The Return of Central Planning

- Identify... the input targets that would be needed for the country to achieve the MDGs by 2015. .. cover hundreds of interventions ...that need to be provided to meet the Goals. ...The second stage of the planning process will be for each country to develop a long-term (10-12 year) framework for action for achieving the MDGs, building upon the results of the MDG needs assessment. ... The third stage of the planning process will be for each country to construct its medium term (3-5 year) poverty reduction strategy (PRS) and, where appropriate, its Poverty Reduction Strategy Paper (PRSP) based on the long term MDG plan ... and should be attached to a Medium Term Expenditure Framework (MTEF) ... Fourth, both the 10-year framework and three-year PRS should include a public sector management strategy... the Millennium Project secretariat has been co-ordinating a multi-step process to develop a methodology for country-level MDG needs assessments. (UN Millennium Project 2005)

The World Bank/IMF **Poverty Reduction Strategy Paper** : another example of top-down Planning

- “The sector ministries prepare medium-term **strategic plans** that set out ... **key objectives**, with their associated outcomes, outputs, and expenditure forecasts ... These **plans** should consider the costs of both ongoing and new **programs**....”
- The PRSP should also include “an external assistance **strategy** in the context of the PRSP process that explicitly identifies the **priority sectors** ... More detailed external assistance **strategies** can then be developed for **key areas** ... in which major donors and line agencies participate... within the **framework** of a global external assistance **strategy**...”

The Knowledge Problem with Plans

- UN Plan mentions 449 separate actions to reduce poverty.
- Planners at the top can never have enough information to know what are the right actions in the right place at the right time, or how to make the action work in local circumstances.
- “The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.”
Friedrich Hayek

The Searchers

- Aid could do more good if it concentrated on (and individual actors were held responsible for) what it could conceivably do -- specific marginal steps that help individuals, rather than achieving overall growth or development.
- Found by “Searchers” analogous to private entrepreneurs in markets – examples: Mohammad Yunus and microcredit, Santiago Levy and the Progresa program, Michael Kremer and worm eradication in western Kenya.
- Of course these things are too small to achieve overall development, but they convey real benefits on poor people, and that’s all we should ask of foreign aid.
- How to achieve development remains a vibrant intellectual question (not covered in this presentation), but it is separate from the question “what can aid do?”

Principles for solutions to foreign aid problems

- When something doesn't work, discontinue it. When something does work, do more of it.
- Induce this with INDEPENDENT EVALUATION of aid efforts, to reward pragmatic Searchers and expose the ineffective grandiosity of Planners.
- Keynes quoted by Mankiw (2006):
- “If economists could manage to get themselves thought of as humble, competent people on a level with dentists, that would be splendid.”
- We can't save the world, but let's at least be good dentists – to devise incentives for aid actors so that aid does finally reach the world's poor.