Why Aid Is Not Dead. How To Improve Its Effectiveness

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Abstract

Section 1 starts from the recent provocative essay by Dambisa Moyo “Dead Aid” to discuss several issues that hinge upon aid effectiveness, its measurement and complex causations, explaining why so many opposite conclusions have been drawn from various attempts to find a positive causal relation between aid and aggregate growth. Section 2 dwells on various policy implications for donor and recipient countries’ governments, ranging from budget support and related conditionalities to untying of aid, public-private partnerships, aid-for-trade schemes. Section 3 concludes with some recommendations and proposals to improve aid effectiveness.

Introduction

The topic of effectiveness of Official Development Assistance (ODA) is not a new one in the economic literature and in international official papers. The “Partners in Development” report, launched in 1969 by the Commission chaired by Nobel Prize winner Lester Pearson (Pearson 1969), is still a significant paper today. In recent years the issue has been the focus of numerous official declarations, including the Monterrey Consensus (2002) the Paris Declaration (2005) and the recent Accra Agenda for Action (2008). At the same time, a wealth of economic literature developed which, taking a political economy approach in which the donor country has a kind of principal-agent relationship with the beneficiary country, put forward proposals to increase ODA effectiveness, operating all along the causal chain between the donor and the rulers of the beneficiary country and between those and the actual measurable results in the recipient country (see, for example, Bourguignon-Sundberg 2007; Severino-Ray 2009 and numerous other contributions from the Center for Global Development: www.cgdev.org).

Section 1 below lists the reasons why a number of economists, but also several people involved on the ground, are quite doubtful about ODA’s effectiveness in facilitating poor countries’ growth.

(*) A background contribution by Lorenzo Rotunno to a former version of a paper prepared for CNEL (the Italian Economic and Social Council) is gratefully acknowledged.
Trying to estimate ODA purely in terms of impact on growth and GDP is a gross oversimplification. Not least in the light of the growing debate on welfare indicators complementing GDP, stimulated by the Stiglitz-Sen-Fitoussi report (2009), but especially as suggested by many specific studies on poverty (Sachs 2005, Barder 2009), escaping from underdevelopment is a complex process which varies substantially from country to country. Fighting poverty involves many aspects of human development and people's welfare. Responses to basic needs – such as freedom from hunger, illness, lack of basic knowledge and violence – cannot be measured by the simple arithmetic of GDP growth, particularly in a short-to-medium-term perspective.

In Section 2 a number of conditions and recommendations are set out for putting together a bilateral and multilateral ODA policy which is more effective in practical terms, introducing new intervention instruments and aiming to involve the most active elements of the private sector as much as possible.

1. Why does aid often fail to achieve its goal?

The intentionally controversial statements of the African economist, Dambisa Moyo, in Dead Aid. Why is Aid not working and how there is another way for Africa (Penguin Books 2009) should not be underestimated. Ms. Moyo’s opinion is, on the whole, a radical one, biased and a bit unfair. A native of Zambia with a PhD in Economics from Oxford and a Masters from Harvard Kennedy School of Government, Moyo, a World Bank consultant and for many years an analyst at Goldman Sachs in London, writes: "Millions in Africa are poorer today because of aid; misery and poverty have not ended but have increased. Aid has been, and continues to be, an unmitigated political, economic and humanitarian disaster for most parts of the developing world." (Introduction, p. xix). With a rather different tone, back in the nineties, the World Bank came to the following candid conclusion: "Foreign aid has at times been a spectacular success – and an unmitigated failure" (World Bank 1998). And in recent years the debate on aid effectiveness has developed at various levels of these international organisations, in particular the multilateral development banks of the World Bank Group. Moyo’s book is a useful provocation to resume the debate on why many hopes of success of ODA have been disappointed. Rather than drawing pessimistic and defeatist conclusions, It should trigger proposals for improving instruments and policies. Clearly, as many sources (e.g. Oxfam) point out and as suggested by the experience of countless operations with well proven encouraging successes (e.g. a tenfold increase in the number of patients with access to HIV-AIDS prevention healthcare, 33 million children taken back to school), it would'nt make sense to strike ODA policy off governments' agendas because of those disappointed hopes, which would merely result in a quite dangerous delay in the fight against world poverty and underdevelopment. A fight which, as late as 2007, saw nine million children under five die because of a lack of effective preventive treatment, 350.000 women and young mothers die because of
of complications during pregnancy, 72 million children go without elementary schooling and 750 million illiterate adults.

Economists' assessment of development is certainly much less drastic, although far from wholeheartedly optimistic. An abundant specialised literature based on econometric tests on wide samples of countries over many years, looking at the complex web of variables influencing the growth of a country and trying to isolate the specific role of aid, has not produced any conclusive results about the effectiveness of ODA in raising the aggregate growth rate (GDP, per capita GDP) of the recipient countries. Various contributors have written on this subject: among them Easterly (2003), Rajan Subramanian (2008), Roodman (2007) and Doucoliagos and Paldam (2009).

An Inter-American Development Bank study on the thirty-year period 1972-2002 finds at first glance that ODA seems to have only slightly improved income distribution in the beneficiary countries. However, it acknowledges that such results are not robust when quality of institutions is introduced into the equation: indeed this "is consistent with recent empirical research on aid ineffectiveness in achieving economic growth or promoting democratic institutions" (IDB 2006). Moreover, it cannot be forgotten that a number of Latin American countries were subject to political dictatorships during that time, which were certainly not concerned with prioritising policies for social cohesion and fighting poverty.

There are various possible explanations for why it is hard to find convincing statistical proof that ODA helps increase recipient countries' economic growth. In the words of Rajan and Subramanian, two of the most seasoned economists who are most keen to this issue, in the conclusions to the above-mentioned work (2008): "First, it should be stressed that our findings, which relate to the past, do not imply that aid cannot be beneficial in the future. But they do suggest that for aid to be effective in the future, the aid apparatus (in terms of how aid should be delivered, to whom, in what form, and under what conditions) will have to be rethought. Second, our findings force us to ask what aspects of aid offset what ought to be the indisputable growth enhancing effects of resource transfers. Understanding the hindrances is essential to any effort to making aid more effective."

1.1 It should first and foremost be borne in mind that - on the basis of sound economic theories as well as statistical evidence - the essential conditions for countries' growth have to do with numerous well known macroeconomic and structural variables such as: household saving capacity, amount of businesses' and public administrations' investments, absence of destabilising monetary and fiscal policies generating high inflation and a weak exchange rate, international competitiveness of national services and industry, availability and quality of "human capital", dissemination of information and communication technology (ICT). There are very close links between these macroeconomic variables and
the issue of the quality of institutions referred to in point 1.9 below. Some of these conditions can be facilitated by effective ODA policy (e.g. education investment aid, technical cooperation initiatives for agricultural and industrial development), but with regard to many others donor countries cannot and should not be a substitute for responsible (or irresponsible) choices of beneficiary countries.

1.2 It can, of course, be stated that when ODA succeeds in increasing supply of basic infrastructure (water, energy, roads, railways, telecommunications, schools, hospitals etc.), its indirect impact on growth is very likely to be significant in the medium-to-long term, but is still very difficult to identify through conventional econometric regression analysis of historical data or – even more difficult – panel data. Alongside many success stories, such as implementation of major energy, transport, school and health infrastructure (the latter bringing substantial reductions in endemic diseases and mortality rates), there are distasteful but not rare cases where ODA has had adverse effects on development. One of these cases is food aid, which puts local production out of business, as happened in Lesotho with increased grain imports from South Africa, following an initiative by Canada aimed at improving road access infrastructure between the two countries. An even more awkward, although very unusual case, was the World Bank project improving road conditions in Sierra Leone during the brutal 1998-2001 civil war, which simultaneously facilitated destruction of civil works by armed groups and paid out compensation for damages to the construction firms (Easterly 2003, p. 36). These are obviously very special cases, which in no way detract from the decisive impact on local development of many infrastructures financed by aid in numerous Asian, African and Latin-American countries during the second half of the last century and also more recently. However, as pointed out in section 2, aid effectiveness is crucially dependent on the ability of donor countries and multilateral organisations to grasp the complex issues and interdependencies which have marked the country’s history and will affect its future prospects.

1.3 Econometric analysis attempting to find a positive causal relationship between ODA (exogenous variable) and growth (endogenous variable) inevitably comes up against the well known problem of endogeneity or bilateral causality, since the recipient country's growth rate may in its turn be negatively correlated with ODA flows. By definition this happens whenever for humanitarian reasons the donor country and/or the multilateral international organisation channel their aid precisely towards countries with lower growth and higher poverty levels. In these cases modern econometric analysis employs "instrumental variables" (linked to ODA supply but not directly linked to the country's growth: e.g. political and cultural ties dating from colonial eras), lagged variables and other calculation techniques. In general, many doubts remain regarding the robustness of these estimates trying to get round the endogeneity problem. In fact, these data processing techniques are highly disputed, while the complex causal directions are in any case rooted
in the history of the events. In one of the more accurate recent econometric studies, based on data from 33 countries in the eighties and nineties with 28 disaggregated manufacturing sectors, Rajan and Subramanian (2008) concluded that, far from boosting the growth of the manufacturing industry, ODA reduces it. At the end of a previous study on ODA and aggregate growth, the authors wrote that "there is no robust positive relationship between aid and growth," but that this does "not imply that aid cannot be beneficial in the future" (Rajan-Subramanian 2005, p.19).

1.4 The issue of endogeneity in the relationship between ODA and growth is related to that of the determinants of aid from the point of view of the donor countries. Literature on the subject opposes donor interest and recipient interest, associating the former with the practice of bilateral tied aid, while bilateral or multilateral untied aid is deemed in principle to be solely or primarily weighted towards the interest of the beneficiary country (e.g. Alesina-Dollar 1998). Bilateral aid involves commitment by the beneficiary country to transfer financial aid in purchase of goods and/or orders for work from donor country businesses, outside any tender procedures and often under more or less hidden political collusion between governments (politically driven tied aid). Tied aid often inappropriately favours the non-transparent role of intermediary consultants, ending up with increasing administrative costs to the detriment of the resources available for the targeted beneficiaries in the country. In these cases the donor country can intentionally or otherwise impose prices for supply of goods and services which are above market prices, causing economic harm to the beneficiary country, which is not in a position to operate on a competitive market. Examples of this "bad quality" aid are given in (Oxfam 2010, p. 13-14).

Moreover, bilateral tied aid is incompatible with some of the principles which the World Bank oft claims as necessary to underpin a proper aid policy, in particular the alignment with the strategic priorities of the beneficiary country and harmonisation (multilateral consistency). For sure the recipient country can derive clear benefits from this kind of aid. However bilateral tied aid increases the risk of operations which are not in line with the genuine needs of the recipient country, and provides more incentives for corruption of those involved, starting with the rulers and administrators of the recipient country. Multilateral organisations emphasize the need to keep tied aid to a minimum. Tied aid not only increases the ever-present temptation of corruption for both parties (Easterly 2001, chapter 12; Oxfam 2010 p. 30-33), but it also gives rise to inappropriate costs and distorts competition to the detriment of development. As already remarked by the Pearson Commission (1969, p. 173), development trends in the foreign trade of beneficiary countries were being distorted, markets were being unhinged and inefficient sectors encouraged by extensive use of bilateral tied aid. It is estimated that the cost of distributing tied aid is 15-30% higher than for untied aid. Imposing services provided by the donor country, with obvious significant returns for the donor, often discourages the supply of local labour.
1.5 A typical macroeconomic variable which often seems to have played a role in discouraging (rather than boosting) growth is the (unintended) effect of the appreciation (or failure to depreciate) of the beneficiary country's real exchange rate, following an influx of foreign currency from donor countries (see Rajan-Subramanian 2005, 2008). It is a specific case of what is known as "Dutch disease", which - in a completely different context from ours - characterises countries in which revenues in the balance of payments are substantially inflated by the rise in the prices of exported primary resources, leading to unwanted appreciation of the nominal and real exchange rates. This appreciation in itself penalises the international competitiveness of the manufacturing industry based on relative costs and prices, something which – as pointed out at the beginning – plays a major role among the macroeconomic determinants of growth.

1.6 For the purposes of analysing the impact on development, ODA should, however, be divided into major categories. In some cases (such as food and humanitarian emergency aid, stemming war atrocities, receiving refugees), the aid cannot or can only to a small degree be programmed over time and is placed in an already destabilised context. In particular, humanitarian aid provides clear support for subsistence consumption and, as such, does not have effects on the above-mentioned macrostructural variables which foster growth. (On the contrary, in certain cases it is no surprise to find a negative correlation.) It is estimated that about half of the ODA disbursed to Sub-Saharan Africa has gone to countries torn by civil war and military coups d'état. Military aid, which is not counted as part of ODA, serves a completely different purpose, and can regrettably help increase conflict within and outside the country, with harmful consequences for the country's growth.

The fact remains that the USA, the leading donor country in terms of amounts disbursed, has always attached primary importance to the geopolitical function of ODA (security, conflict prevention, transition from communism), as has been shown by its commitments from the time of the Marshall Plan to more recent relationships with countries such as Israel, Egypt, Jordan, Turkey and Columbia (Lancaster 2000, World Bank 1998).

1.7 Aid taking the form of full or partial cancellation of the country's foreign debt certainly brings benefits for the beneficiary country, insofar as the country is enabled – once the weight of its past debt has been lightened – to launch genuine fiscal policy encouraging development. However, the governments benefiting from debt cancellation do not always seem to act so wisely: debt cancellation can simply serve to relax the budgetary constraint
on non-productive expenditure by the ruling class. Hence the severe critical judgment of William Easterly (2001, chapter 7) on the real impact of the initiative leading to debt cancellation of Highly Indebted Poor Countries (HIPC}s). The initiative was launched during the June 1987 G-7 summit (Venice terms), was officially adopted after various readings (Toronto 1988, Trinidad 1990, Naples 1994) in September 1996 by the World Bank and the International Monetary Fund and was implemented through the Paris Club, coming to a total cancellation of USD 3.4 billion. The initiative pointed to enabling 41 HIPC}s (including 38 Sub-Saharan African countries) to escape once and for all from the process of debt rescheduling, so as to re-establish normal relations with the international financial community, characterised by spontaneous financial flows and full respect for commitments on the part of debtors. A large part of that foreign debt was and continues to be essentially irrecoverable by creditors, and as such unilateral cancellation thereof almost becomes an exercise in cleaning up accounts. However, the other side of the coin cannot be ignored, as emphasised by Easterly (2001, p. 127), who argued against the supporters of the Jubilee 2000 campaign (including the economist Jeffrey Sachs, the singer Bono, the Dalai Lama and even Pope John Paul II): "High debt may remain a persistent problem just because high debt reflects irresponsible governments that remain irresponsible after debt relief is granted". Many years earlier, the prestigious economist from Chicago, Harry Johnson (1967 p.80), talking about inefficiency in aid policy, argued that use of loans instead of donations generates inefficiency, insofar as the debtors are induced to underestimate the economic burden arising from commitment to future repayments. The World Bank itself, in its official documents, clearly highlighted this danger (World Bank 2000, p.23).

Much less pessimistic comments can be made about cases in which debt is converted, under the strict supervision of the donor country, to development projects funded in local currency. In Italy, Law No 449 of 27/12/1997 provided for this kind of debt conversion into human, environmental or trade projects. For example, the Ministry of Foreign Affairs' Directorate General for Development Cooperation identified among the "good practices" of Italian cooperation the conversion of USD 150 million of the credit component of aid to Egypt's debt into 53 projects, which were completed by the end of 2008. This initiative was to be followed by a second five-year programme for 2007-2011 to convert a further USD 1000 million. Overall, Italy has devoted almost EUR 950 million to this initiative. Innovative instruments to address the issue of irrecoverable debt also include the “debt for equity swap” instrument, where the donor country converts its credit into purchase of ownership rights for local resources of the debtor country.

1.8 A more general argument, although convincing empirical proof is lacking, is that in many situations the influx of aid from abroad discouarges households, businesses and banks from greater savings and investments, while at the same time discouraging the
government from attempting to expand the tax base necessary to provide public goods - a kind of "aid dependency" which discourages healthy processes of private accumulation and does nothing to attract direct investment from abroad either.

1.9 However, maybe the most important explanation of cases in which ODA does not succeed in boosting growth is related to the very wide interpretation of "quality of institutions" in recipient countries, a notion linked to complex categories (historical, legal, sociological, politological) which are hard to measure accurately in a non-arbitrary way. Aid effectiveness is clearly compromised by the lack of strong, transparent institutions (central and local governments) which should provide certain fundamental pre-requisites for the development of a market economy, such as essential physical infrastructure (access to healthcare and basic needs like water, energy and transport), education, civil rights and a legal framework. However, all too often the effects of past ethnic and religious conflicts jeopardise aid effectiveness, along with autocratic governments and corrupt, incapable governing classes. There is no shortage of econometric estimates here, too, where ODA is only shown be to be effective in terms of growth where there are a number of indicators of a sound macro-economic context (inflation curbed with stabilising monetary policy, tax pressure under control, exchange rate not overvalued) and where there are "good quality institutions" (Burnside-Dollar 2000). However, other research with the same data and similar international comparisons over several decades of development of the world economy challenge these results (Easterly-Levine-Roodman 2004, Roodman 2007).

Without wishing to perform an econometric analysis, there is, however, a wealth of past literature dating at least from the fifties (starting with the classic Lewis (1955, chapter 3) up to the more recent contributions of North (1990), Landes (1999), Sen (2000), De Soto (2000), Rodrik (2003) and Collier (2007). The numerous instances of aid policy failure are almost always associated with contexts where wars, violence, ethnic conflicts, corruption and lawlessness divert aid to inappropriate uses (donor countries may be guilty of connivance), sometimes stimulating the centre of the conflict itself, as happened not so many years ago in Zaire (now the Democratic Republic of Congo), Kenya and Uganda (World Bank 1998). On the other hand, there are examples of development with peaceful coexistence among three different ethnic groups in African countries such as Zambia, Botswana, Ghana and Mali.

In particular, Botswana is an interesting case, where the ratio of ODA to GDP was initially high but the funds were wisely channelled into providing essential public goods, thus making the country increasingly less dependent on further external aid.
The vicious circle of endemic corruption and aid – which, as has already been said, often calls into question the responsibilities of the donor countries – is one of the aspects on which Dambisa Moyo calls for greater attention: "The list of corrupt practices in Africa is almost endless. But the point about corruption in Africa is not that it exists: the point is that aid is one of its greatest aides. (...) Foreign aid props up corrupt governments – providing them with freely usable cash. These corrupt governments interfere with the rule of law, the establishment of transparent civil institutions and the protection of civil liberties, making both domestic and foreign investment in poor countries unattractive. Greater opacity and fewer investments reduce economic growth, which leads to fewer job opportunities and increasing poverty levels. In response to growing poverty, donors give more aid, which continues the downward spiral of poverty. (Moyo 2009, p.48-49).

2. Policy implications for donor and recipient countries’ governments

2.1. The latest studies on the effectiveness of aid emphasise the need for policy coherence and an omnicomprehensive approach ("whole of the country") in the planning of ODA policies (e.g. DAC 2009, p. 42-43) This not only refers to the macroeconomic and infrastructural policy requirements needed at the outset, but also to the complementarity of ODA and financial inflows from private donations (including migrant remittances), business loans and direct investment. In fact, the donation of material goods by individual donor countries, which in itself aims at fighting poverty, can undermine sustainable development in the absence of a credible "country project". For example, this is the case for food aid that provides a disincentive to converting subsistence farmland into commercial farmland, including cash crop production or even farming for potential export markets, with benefits for local farm incomes. Another example is the donation of mosquito nets, which undermines the emerging local craft industry producing the same nets. This emphasis on policy coherence reminds the earlier 1960s debate - triggered by the new guidelines set by the Kennedy presidency in the United States - on the need to shift from project aid, influenced by powerful interest groups in donor countries, to multilateral programme aid, designed to set a coherent framework for self-sustaining development (Pearson 1969, chapter 9, Hirschman-Bird 1968).

Policy coherence assumes even greater relevance when we consider the growing interlinkages between apparently different factors such as climate change (with dramatic consequences for desertification and access to water in vast underdeveloped areas); food security and inconsistencies in the agricultural policies of rich countries (Europe first and foremost) that subsidise national production to the detriment of potential imports from southern agricultural countries; migration and development funding. The latest report of
the European NGO Confederation for Relief and Development dwells on this growing need for policy coherence (Concord 2009).

With regard to institutional building in developing countries, we should not forget the message set out in Hernando De Soto's work (2000) on appropriate ways to promote the transition from the informal economy (which is dominated by the absence of rules on ownership rights and administrative justice, undermining the accumulation of capital and technology dissemination) to a gradually more advanced market economy. It should be remembered that without a commonly shared underlying body of laws (Rule of Law), including fundamental human rights, sustainable development has very dim prospects.

2.2 One way to reduce the volatility of ODA flows and increase the consistency of the policies of local governments is to explicitly link parts of assistance programmes to budget support, thereby incorporating them in the beneficiary country's overall public finance framework for at least three to five years. This is a sensitive issue because it should not amount to giving local governments carte blanche in the allocation of funds, with the obvious risk (unfortunately not a theoretical one) that donor resources will be used to support corrupt bureaucracies and fund projects far removed from the population's stipulated basic needs, or even to strengthen the power of dominant oligarchies and worsen human and civil rights abuses.

On the contrary, budget support should be matched by strong donor monitoring, "good conditionality" and greater transparency in the reallocation of assistance, including the effective and valuable participation of NGOs operating in the country. At the same time, this instrument can contribute to greater consistency with the local government's public spending plans, especially in investment terms, with expected medium to long-term impacts (infrastructure, health, education, vocational training etc). There is some scanty evidence that countries benefitting most from budget support from the European Commission have significantly increased their investment in health, education and access to basic social services. Independent monitoring of budget support in various African countries and in Vietnam show a significant increase in public spending on pro-poor programmes and the extension of social services. At present, less than half ODA inflows are accounted for in the budgets of recipient countries and less than 10% is granted as budget support (Oxfam 2010, p. 18-22).

Nevertheless, some NGOs express reservations regarding the donors' capacity to guarantee these conditions for "good conditionality". They also stress that, in the final analysis, budget
support ultimately gives governments an alibi for inappropriate allocations, less transparency and less involvement for social operators in the country.

2.3 The World Bank frequently calls to form partnerships with local operators and to promote their sense of ownership and empowerment in order to deliver successful project outcomes. As already stated, the role played by many NGOs (voluntary organisations, foundations, charities etc.) assumes particular importance due to their often acute understanding of local realities and culture, their well rooted presence across regions and villages and their focus on basic needs (health, education, child nutrition etc.). An important role is also played by private resources from philanthropic organisations (e.g. the Bill & Melinda Gates Foundation, the Global Fund, the Aga Khan Foundation), universities, and technology research databases and centres with the capacity to launch programmes involving the private sector.

2.4 Sustainable development relies on the country’s businesses being more oriented towards international trade, but aid is hardly geared to this purpose. Aid for Trade is an interesting category, although at present it is not widely practiced and, as a result, its effectiveness cannot be assessed with accuracy. Aid for Trade aims at strengthening the organisational capacity of businesses and institutions, by developing their culture of openness and directing the local farming and manufacturing sectors towards exportable production.

Basically, Aid for Trade seeks to remove barriers and strengthen the supply side with a view to enhancing national resources in an open economy. The technical tools used serve two purposes, namely to provide (a) financial and technical support to enable local governments to tackle the costs inevitably incurred by greater exposure to international competition: for example reduced tax revenue from lower import duties, not to mention the cost of administrative reforms associated with simplifying Customs practices and complying with trade agreement obligations; and (b) financial and technical support for government initiatives to stimulate supply (logistical and transport infrastructure, access to credit and education (Helble-Mann-Wilson 2009, p. 2007)). In its broader meaning, which includes road transport and port infrastructure, the OECD estimates that Aid for Trade as a percentage of total ODA has fallen from 50% in 1996 to about 30% in 2006 (Gamberoni-Newfarmer 2009, p. 19). Interesting examples include the North-South Corridor project linking China and Thailand via Laos (funded by the Asian Development Bank), the Inter-American Development Bank project to shorten customs procedures for goods from Latin
America (ITC 2009), and the European Economic Partnership programme with the Caribbean region, launched in December 2007 (Pinto Moreira 2010). Similarly, the Enhanced Integrated Framework Trust Fund for Least Developed Countries was launched in 2009 to help LDCs benefit from greater integration in world markets. It is still too early to assess the impact of this Fund, through which 23 contributing countries provide a modest total of $100 million, and which currently supports 20 projects.

Although the empirical outcomes regarding the effectiveness of the Aid for Trade initiative are disappointing, it remains fundamentally true that sustainable development of poor countries depends on their increased capacity to make better use of their own natural resources, especially their human resources, with emphasis on growth in the agricultural and industrial sectors and in international market-oriented services. This applies to export outlets as well as to national production gradually replacing imports.

2.5. Opening poor economies to international trade calls into question the role that private capital (FDI: Foreign direct investment) can play alongside ODA via profit-oriented initiatives, but which together would be capable of activating underutilised local resources. Unlike straightforward trade (import-export), FDI inflows can significantly promote an entrepreneurial, technological and organisational culture by developing a network of small local suppliers.

This applies in good measure to investment in manufacturing sectors. However, the same cannot be said for the extraction industries (minerals, oil, gas) and primary agricultural products (timber, cereals, tropical products, cotton, unprocessed hides and skins, etc.). In these sectors, the purely "colonial" exploitation of local resources and consequent revenue outflows to the foreign investor (not to mention serious environmental damage) could outweigh the beneficial impact on local development. Nevertheless, some studies argue that even direct investment in the mineral sector, albeit subject to many limits and risks, can have positive direct and indirect impacts for the host country (e.g. new transport infrastructure and access to water, dissemination of improved standards in the use of environmental resources, literacy, and training skilled workers): cf. UNCTAD 2007.

For multinational investors looking for profitable undertakings around the world low labour costs are not enough to offset hindrances and disadvantages like distance from seaports, inadequate infrastructure, low productivity and human capital of the local labour force, absence of rules on ownership rights, unreliable bureaucracy, and chronic political instability.
3. Some concluding recommendations

In short, while it is true that there still are many knowledge gaps regarding the complex mechanics of development and underdevelopment, Parliaments and governments should seriously rethink international and national ODA policy, at least in the following areas:

a) promoting a close examination of transfers provided to beneficiary governments under the budget support scheme, so as to avoid giving the government of the beneficiary country carte blanche and to facilitate consistency with explicit and measurable objectives for social spending over the medium term, also in light of the Millennium Development Goals compliance with ILO Labour Standards;

b) giving new impetus and real management autonomy to a body (independent of the government but accountable to parliament) tasked with monitoring and detailed assessment of outcomes;

c) more generally, shifting national bilateral aid policies away from tying aid and, above all, giving preference to assistance that is as closely adapted and conditioned as possible to the gradual and realistic attainment of the expected outcomes. This requires a transparent and negotiated agreement with the recipient country on concretely measurable objectives (“cash on delivery”, “conditional cash transfers”) such as the number of children successfully completing their school education; the number of patients receiving antiretroviral treatment; the number of vaccinated people; the number of villages given access to water, and so on;

d) aid for trade: increasing the amount of assistance specifically earmarked for productive capacity building (agriculture, craft and manufacturing industries and services) geared to export to foreign markets, including distant and profitable markets in order to foster the development of self-sufficient businesses and a better qualified labour force. Aid for Trade practices that directly and indirectly foster the infrastructural and economic and production conditions are liable to speed up the transition of local production systems from over-concentration on primary raw material exports to a more diversified supply of manufacturing activities and services that provide added value and increase the country's qualified human capital.

e) encouraging greater private sector involvement, including non-profit organisations (public-private partnership in the best sense) and especially of businesses and organisations capable to transfer technologies and organisational knowledge, which are vital to ensuring that ODA genuinely promotes bottom-up development (once again, capacity building, empowerment, ownership, greater democratic participation
for the country's identifiable social forces). To this end, fostering and accompanying methods for financing self-sustaining development through microcredit, credit cooperatives and similar instruments that help provide access to credit to broad segments of the population (especially women) with productive potential, but forced to unemployment or very low productivity due to the absence of a decently open market.

f) When allocating ODA geographically, two contrasting needs have to be weighed against each other by the donor. On the one hand, it may make sense focusing on a specific number of countries facing adversity or conflict (Afghanistan, Iraq, Lebanon, Sudan) and/or with particularly weak institutions (Somalia, Sierra Leone, the Ivory Coast) in order to help them improve their chances of a less fragile future. On the other hand, one must make sure that ODA is not wasted and (worse still) used to facilitate and support despotism and corruption as a direct result of the fragility of institutions.

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