

The Economic Impact and Effectiveness of Development Aid

One in five of the world's population still lives on less than \$1.25 a day. This poverty is a source of great human misery, and, if effective ways can be found to reduce it which are acceptable to the taxpayers of the developed world, then reduce it we should.

This report is about development aid, and how effective it has been in promoting development and poverty reduction in recipient countries. It examines the Government's plans for a real terms increase of 37% in official aid spending in the four years to 2015. The report does not address humanitarian aid for relief of acute distress following conflict, famine, natural disasters or other emergencies, which is less than 10% of official aid spending.

This inquiry has shown that finding ways to realise the simple ambition of reducing poverty by means of development aid is hugely challenging:

- Economic growth is essential if poverty is to be reduced. There is however no agreement amongst experts as to the effectiveness of development aid in promoting growth. Estimates vary from those which suggest that development aid has added about 0.5 per annum to growth in recipient countries to those which suggest that it has had no positive, or indeed negative, effect on growth.
- There is far from universal agreement amongst experts as to what the aim of aid should be. Should it be to maximise economic growth? Should it be to have the maximum effect on poverty? Or should it for example be a tool for ensuring that values such as human rights are spread more widely, or for combating climate change? These objectives are not necessarily in conflict but they do complicate the design of aid policy.
- There is little agreement amongst experts as to what forms of aid are the most effective. For example, some of our witnesses thought it important to promote foreign direct investment. Some thought that technical assistance was central while others were keener on large-scale projects designed, for example, to combat disease. Different arguments were advanced for project-based aid, for governmental budgetary support and for large scale infrastructure investment.
- There is disagreement among experts as to what is the best way to channel aid. Some argue for multilateral aid on the grounds that it is better for delivery of large-scale development assistance and reduces the number of different donors which aid receiving countries need to keep informed and involved. Others believe that multilateral aid, including aid through the European Union, can be wasteful and that national aid, at least so far as the UK is concerned, is better controlled. Some emphasise the benefits of channelling aid through NGOs and civil society organisations; others emphasise that such organisations can lack scale, and that competition between them can undermine aid, for example by tempting them to make concessions to corrupt governments to preserve their programmes.
- There is also disagreement amongst experts as to whether aid should focus on those countries where poverty is most acute—often "failed" or "failing" states—and those who believe that, without better governance, aid will prove a waste of time or worse.
- There is disagreement amongst experts as to whether aid is a tool enabling donor countries to combat corruption and bring about internal peace, or whether it tends to feed corruption and sustain damaging internal conflicts.

We are however pleased to report that expert opinion is virtually united in agreement that DFID enjoys an outstanding reputation internationally as an effective aid agent. It has refined the Government's approach to aid over a number of years. Now, under an energetic Secretary of State, it is taking direct action to deal with points made by aid critics by for example, increasing its emphasis on promoting private investment and on containing unrestricted budgetary support.

We do make recommendations designed to improve DFID's performance further. In particular we fear that, sometimes, it is pursuing various good objectives—helping fragile states, zero tolerance of corruption, cutting staff numbers—that are likely to prove mutually incompatible.

We have not sought in this report to reconcile all these different arguments. We have sought to form a balanced view of aid, which recognises its strengths and weaknesses. And, in particular, we have sought to apply that view to reach a sensible verdict on the future of Britain's aid programme so as to ensure, to the maximum extent possible, that it does what taxpayers expect of it: make people in the least developed countries less poor and less miserable.

Summary of Conclusions and Recommendations (1-28)

1) This report focuses on development aid which is over nine-tenths of official aid spending. It is not about humanitarian aid, which accounts for less than 10% of official aid spending. We fully support humanitarian aid. (para 3)

2) Since private capital flows to developing countries are now so much greater than official aid flows it seems clear that private spending has become a much greater contributor to development than official aid. (para 11)

3) Economic growth is essential to bring about poverty reduction in developing countries. Aid is plainly not the main driver of their growth, since capital and trade flows are so much greater, but it can arguably play a catalytic role. We consider in this report what impact aid makes on recipient countries' growth. (para 18)

4) The difficulties of accurate measurement and attribution, and of assessing what would have happened if no aid had been given, are so formidable that the evidence that aid makes a contribution to growth in recipient countries is inconclusive. (para 32)

5) Large and prolonged aid programmes can have a corrosive effect on local political systems when the priority becomes to attract aid rather than to solve problems. DFID should pay close attention to the scale and composition of aid programmes to ensure that resource flows do not overwhelm local ability to manage them and undermine systems of governance in recipient countries. They should also support recipient governments' systems of audit and public financial management and have a credible exit strategy. (para 36)

6) We welcome evidence of graduation from aid, or progress towards it, by a range of countries in Asia and Africa. We recognise that any contribution by aid to the economic growth which enables graduation may not have been great. We do not subscribe to the fallacy that because graduation took place after aid, it was even in part because of aid, since many factors such as governance, trade and investment affect growth. It seems likely that all contributed, and that aid's impact was greater where, as in Botswana, Ghana or Kenya, it was a higher proportion of GNP in the early days of development and was delivered in support of a clear strategy for growth. We welcome the Secretary of State for International Development's readiness to move with the times and prepare exit strategies in countries where graduation is near. (para 45)

7) The risks of corruption are greater in weak, unstable or failed states. It is important for donors to ensure that opportunities for corruption are as limited as possible by setting in place systems of audit and control as rigorous as local conditions permit and to withhold development aid altogether where corruption is rife and therefore endangers the effectiveness of aid. In the battle against corruption, to which we return later, accountants are more important than economists. (para 50)

8) We recommend that DFID should monitor and report on flows of capital from recipient countries, with a view to reducing aid where there are excessive outflows. We agree with Transparency International that the Government should explore with other G20 countries the scope to discourage illicit capital flight from developing countries. (para 55)

9) Growth seems the most effective remedy for global poverty. We are surprised that the role of growth is not more fully acknowledged in the international community's collective approach to poverty reduction. We recognise that trade, investment and remittances are all much more substantial than aid and more important in driving growth. We accept that accurate measurement of whether or how much aid helps promote growth is not available. But similar difficulties arise over measurement of the contribution to growth of trade, investment and remittances, though their indispensability to growth is undeniable. It is uncertain that aid makes a proportionate contribution. (para 58)

10) The risks of failure in aid to fragile states are greater than elsewhere, as is the scope for misuse of aid funds. For the Government's planned increase in aid to fragile states to have any chance of being effective we recommend careful selection of programmes and continuous evaluation of their effect, and a robust anti-corruption strategy. (para 73)

11) Where security policy and aid policy overlap with the aim of bolstering stability, circumstances are often challenging and outcomes uncertain. Lessons must be learnt from the unrealistic goals set for aid in Afghanistan. In the UK, DFID see the Government's Building Stability Overseas Strategy (BSOS) as a useful aid to decision-making. We agree with Rory Stewart MP who told us that "the liberal imperialist idea ... of creating governance and stability in a post-conflict zone through the application of development aid is mistaken." Decisions on intervention should be carefully weighed on the basis of thorough analysis of local circumstances and realistic and proportionate assessment of what is achievable. (para 74)

12) We agree with Lord Jay of Ewelme who told us that aid should complement British foreign policy. The Conflict Pool provides scope for coordinated responses by DFID, the Foreign and Commonwealth Office and the Ministry of Defence to instability and conflict in developing countries in carefully assessed cases. (para 78)

13) We believe that poverty reduction through economic development should remain the main aim of aid policy. (para 84)

14) We welcome the Secretary of State for International Development's decision to run down bilateral development aid programmes in 16 countries including China and Russia and to concentrate bilateral aid in 27 countries. (para 85)

15) Whatever its merits when it was adopted in 1970, we do not accept that meeting by 2013 the UN target of spending 0.7% (£12bn) of Gross National Income on aid should now be a plank, let alone the central plank, of British aid policy because:

a) it wrongly prioritises the amount spent rather than the result achieved;

b) it makes the achievement of the spending target more important than the overall effectiveness of the programme;

c) the speed of the planned increase risks reducing the quality, value for money and accountability of the aid programme;

d) reaching the target increases the risk identified in Chapter 4 that aid will have a corrosive effect on local political systems.

We recommend that the core of aid policy should be choosing and funding the best ways of promoting international development and stability, rather than finding new ways to spend ever-increasing resources. (para 95)

16) The Government should therefore drop its commitment to enact legislation to enshrine in British law an obligation on future Governments always to comply with the UN target of spending 0.7% of Gross National Income on aid. It would deprive future Governments of the flexibility to respond to changing circumstances at home and abroad. The Secretary of State has not put forward any case for legislation other than the Government's political commitment to it. (para 96)

17) We welcome DFID's reviews of all bilateral aid programmes and multilateral agencies supported by Britain. DFID's renewed commitment to results and value for money is a welcome change in approach, if carried through. (para 98)

18) We welcome DFID's decisions to cease funding to a few ineffective multilateral organisations. But more needs to be done. The evidence we received raised concerns about the quality of aid delivered via the World Bank and in particular the UN Development Programme (UNDP). We would support reducing funding to both organisations, which receive large amounts of DFID money, while a more detailed re-evaluation of their work is carried out. The Government should push for a substantial reduction in the European Commission's aid programmes given its focus on the EU's neighbours rather than poorer, low income countries that are in greater need. DFID must provide impact assessments and regular reports on performance of projects it funds through all multilateral organisations. (para 100)

19) India's impressive economic growth and technological attainments, and its own aid programme, coexist with widespread, extreme poverty. British development aid to the poorest Indian states may provide a perverse incentive to the Indian government to use less of its own revenue to alleviate poverty. We recommend that the Secretary of State should urgently prepare an early exit strategy from the India development aid programme. (para 104)

20) We welcome DFID's decision to halve general budget support by 2014/15. We also welcome the introduction of more rigorous conditions of disbursement. But we are concerned that sector budget support—where the funds are spent in specific areas such as health or education—is to jump 20% by 2014/15 and that much of Britain's funding of multilateral agencies may be used as budget support. Since the risks of misuse of budgetary aid are high, both types of budget support—general and sectoral—should be reduced, not just the general budget support targeted by the Government. DFID should also ensure that less of the aid it provides via multilateral organisations is used for budget support, or withdraw funding from multilateral agencies that persist in focussing on budget support. (para 110)

21) We welcome the new emphasis on the development role of the private sector, which is essential to the creation of strong and sustained indigenous growth. DFID's own efforts should increasingly

concentrate on the ways in which it can help to encourage and sustain private investment. It should not be tempted into interfering unnecessarily in the activities of private companies. The more private sector skills can be embedded within the Department, the more likely its efforts are to succeed, with the prize, at the end of the day, of less taxpayer-funded aid. (para 115)

22) We recognise the difficult case-by-case judgments on aid delivery which DFID faces in easing the plight of the poorest in countries where oppressive regimes violate human rights. We recommend that DFID should continue to exercise vigilance in ensuring aid does not prop up oppressive regimes, even if they are not conspicuously corrupt in a financial sense. (para 117)

23) We recognise the valuable contribution that some NGOs can make to development and agree that DFID should use them in the right circumstances to deliver some of its aid, recognising that the NGO sector cannot substitute in the long run for credible and effective recipient-country governments. We recommend, however, that DFID should be as robust in monitoring proper use of funds by NGOs as it is with directly-delivered resources. (para 124)

24) We welcome the Secretary of State's commitment to ensure better 'badging' of British aid. Other donor governments are less reticent. (para 130)

25) We do not advocate a return to tied aid. But we recommend that DFID should consider with the Department for Business, Innovation and Skills how Britain could derive direct economic benefit from its development aid programmes without worsening quality and effectiveness for recipients. (para 131)

26) The planned combination of much higher programme spending, especially in fragile states, with administrative staff cuts seems to risk weaker monitoring of programmes and less rigorous vigilance against corruption. We are not convinced that a cut in DFID staff of the magnitude planned can be reconciled with adequate control of the Department's fast-growing budget, although we welcome DFID's plans to strengthen the front line within a stable headcount overall, which we trust will lessen the risk. We recommend that the Secretary of State should ensure that administrative staff cuts do not hamper his focus on results and in particular the struggle against corruption. (para 136)

27) There is corruption in many developing countries. We are greatly concerned by the paltry and implausibly low levels of fraud identified by DFID of little over £1m in its global programmes. Given critical reports of the National Audit Office and the Independent Commission for Aid Impact, DFID must make much more strenuous efforts to improve its detection of corruption, especially given the sharp increases in aid over the next few years. (para 143)

28) We recommend that both Parliament and DFID monitor ICAI's own effectiveness closely, and take steps necessary to ensure that both its work and its staffing are sufficient both in quality and in quantity for it effectively to discharge its duties. (para 145)

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