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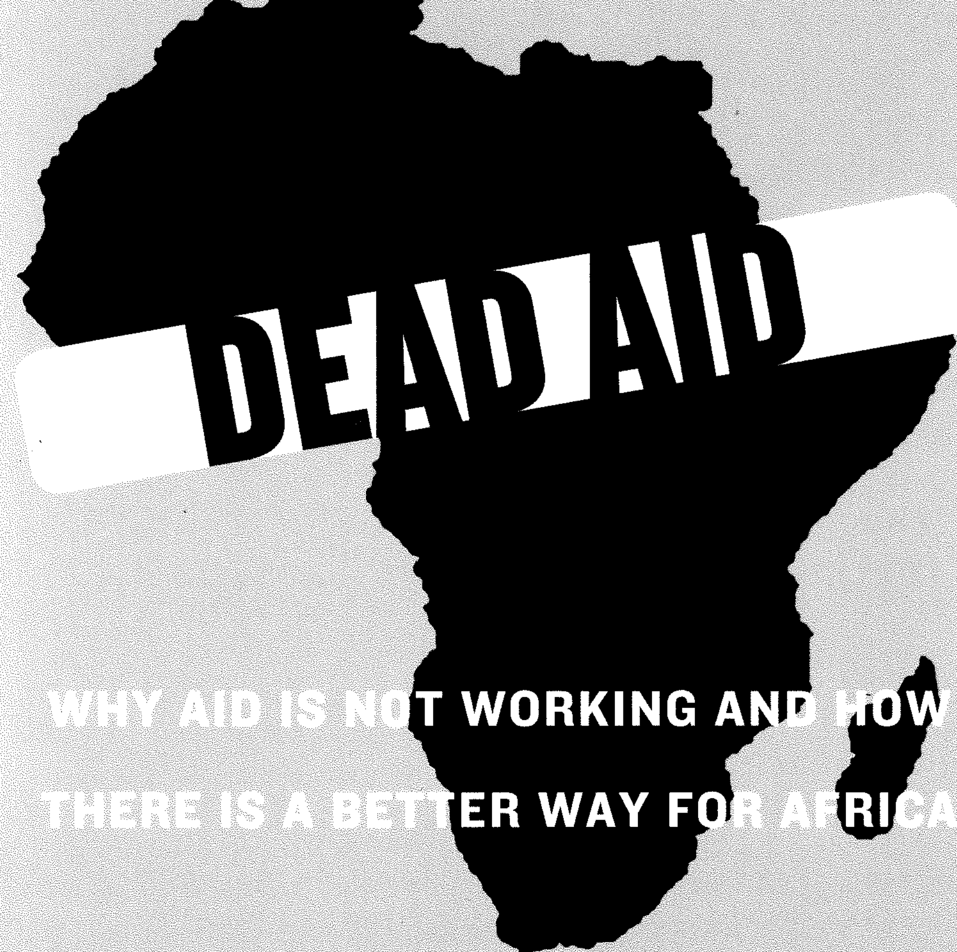

DEAD AID

WHY AID IS NOT WORKING AND HOW THERE IS A BETTER WAY FOR AFRICA

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Introduction

We live in a culture of aid.

We live in a culture in which those who are better off subscribe – both mentally and financially – to the notion that giving alms to the poor is the right thing to do. In the past fifty years, over US$1 trillion in development-related aid has been transferred from rich countries to Africa. In the past decade alone, on the back of Live 8, Make Poverty History, the Millennium Development Goals, the Millennium Challenge Account, the Africa Commission, and the 2005 G7 meeting (to name a few), millions of dollars each year have been raised in richer countries to support charities working for Africa.

We are made to believe that this is what we ought to be doing. We are accosted on the streets and goaded with pleas on aeroplane journeys; letters flow through our mail boxes and countless television appeals remind us that we have a moral imperative to give more to those who have less. At the 2001 Labour conference, the UK's Prime Minister of the time, Tony Blair, remarked that 'The State of Africa is a scar on the conscience of the world', and that the West should 'provide more aid' as, thus far, amidst the multiple problems facing Africa, the continent had received inadequate amounts of aid.[1]

Deep in every liberal sensibility is a profound sense that in a world of moral uncertainty one idea is sacred, one belief cannot be compromised: the rich should help the poor, and the form of this help should be aid.

The pop culture of aid has bolstered these misconceptions. Aid has become part of the entertainment industry. Media figures, film stars, rock legends eagerly embrace aid, proselytize the need for it, upbraid us for not giving enough, scold governments for not doing enough – and governments respond in kind, fearful of losing

popularity and desperate to win favour. Bono attends world summits on aid. Bob Geldof is, to use Tony Blair's own words, 'one of the people that I admire most'. Aid has become a cultural commodity.

Millions march for it.

Governments are judged by it.

But has more than US$1 trillion in development assistance over the last several decades made African people better off? No. In fact, across the globe the recipients of this aid are worse off; much worse off. Aid has helped make the poor poorer, and growth slower. Yet aid remains a centrepiece of today's development policy and one of the biggest ideas of our time.

The notion that aid can alleviate systemic poverty, and has done so, is a myth. 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.

How this happened, how the world was gripped with an idea that seemed so right but was in fact so wrong, is what this book is about. *Dead Aid* is the story of the failure of post-war development policy.

Step by step it will dismantle the assumptions and arguments that have supported the single worst decision of modern developmental politics, the choice of aid as the optimum solution to the problem of Africa's poverty. The evidence is as startling as it is obvious. It will contrast countries which have rejected the aid route and prospered with others which have become dependent on aid and been trapped in a vicious circle of corruption, market distortion and further poverty – and thus the 'need' for more aid.

Others before me have criticized aid. But the myth of its effectiveness persists. *Dead Aid* will offer a new model for financing development for the world's poorest countries: one that offers economic growth, promises to significantly reduce African poverty, and most importantly does not rely on aid.

This book is not a counsel of despair. Far from it. The book offers another road; a road less travelled in Africa. Harder, more demanding, more difficult, but in the end the road to growth, prosperity, and independence for the continent. This book is about the aid-free solution to development: why it is right, why it has worked, why it is the only way forward for the world's poorest countries.

PART I
The World of Aid

4. The Silent Killer of Growth

In 2004, the British envoy to Kenya, Sir Edward Clay, complained about rampant corruption in the country, commenting that Kenya's corrupt ministers were 'eating like gluttons' and vomiting on the shoes of the foreign donors. In February 2005 (prodded to make a public apology for his statements given the political maelstrom his earlier comments had made), he apologized – saying he was sorry for the 'moderation' of his language, for underestimating the scale of the looting and for failing to speak out earlier.[1]

If the world has one picture of African statesmen, it is one of rank corruption on a stupendous scale. There hardly seem any leaders who haven't crowned themselves in gold, seized land, handed over state businesses to relatives and friends, diverted billions to foreign bank accounts, and generally treated their countries as giant personalized cash dispensers. According to Transparency International, Mobutu is estimated to have looted Zaire to the tune of US$5 billion; roughly the same amount was stolen from Nigeria by President Sani Abacha and placed in Swiss private banks (later US$700 million of the loot was returned to Nigeria).[2] It's not, of course, just one person who has taken the money. There are many people, at many different levels of the bureaucracy, who have funnelled away billions of dollars over the years. Corruption is a way of life.

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. This is not to say that there are not other facilitators of corruption. In Africa, natural-resource windfalls, such as oil, have tended to be more of a curse than a blessing. Like aid, they are susceptible to theft and have provided practically unlimited opportunities for personal wealth accumulation and self-aggrandizement.

The crucial difference between foreign aid and natural-resource endowments is, of course, that aid is an active and deliberate policy aimed at development. Countries don't have much of a choice as to whether or not they end up with an oil endowment; although of course they do have a choice on how windfalls are dealt with. With mounting pressure for greater transparency in the oil, gas and mining sectors, from organizations like the Extractive Industries Transparency Initiative (EITI),[3] the days of blatant looting and corruption in these sectors are surely numbered. But donors continue to sit in comfortable air-conditioned rooms in the West and pen the tragic fate of countries they ostensibly seek to help.

The vicious cycle of aid

With aid's help, corruption fosters corruption, nations quickly descend into a vicious cycle of aid. 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.

This is the vicious cycle of aid. The cycle that chokes off desperately needed investment, instils a culture of dependency, and facilitates rampant and systematic corruption, all with deleterious consequences for growth. The cycle that, in fact, perpetuates underdevelopment, and guarantees economic failure in the poorest aid-dependent countries.

Corruption and growth

Ultimately, Africa's goal is long-term, sustainable economic growth, and the alleviation of poverty. This cannot occur in an environment where corruption is rife. There are, of course, any number of ways in which corruption retards growth.

In a context of high degrees of corruption and uncertainty, fewer entrepreneurs (domestic or foreign) will risk their money in business ventures where corrupt officials can lay claim to its proceeds, so investment stagnates, and falling investment kills off growth.

Development agencies would have us believe that aid helps build a lasting, credible and strong civil service. Indeed, the World Bank recommends that by providing more aid rich countries actually assist in the fight against corruption. Thanks to aid, poor governments can afford to support ethics training, increase the salaries of their public-sector employees (police, judges, medical staff, tax collectors), thereby limiting the need for corruption. Moreover, higher salaries will attract competent and higher-quality employees to the civil service.

Unfortunately, unfettered money (the prospect of sizeable ill-gotten gains) is exceptionally corrosive, and misallocates talent. In an aid-dependent environment, the talented – the better-educated and more-principled, who should be building the foundations of economic prosperity – become unprincipled and are drawn from productive work towards nefarious activities that undermine the country's growth prospects. Those who remain principled are driven away, either to the private sector or abroad, leaving the posts that remain to be filled by the relatively less-educated, and potentially more vulnerable to graft.

Endemic corruption also targets public contracts. In these environments, contracts which should be awarded to those who can deliver on the best terms, in the best time, are given to those whose principal aim is to divert as much as possible to their own pockets. What ensue are lower-quality infrastructure projects, and enfeebled public services, to the detriment of growth.

Similarly, the allocation of government spending suffers as corrupt officials are likely to choose projects less on the basis of public welfare and more on the opportunities for extorting bribes and diverting funds. The bigger the project, the greater the opportunity. Projects whose exact value is difficult to monitor present lucrative opportunities for corruption – it is easier to siphon money from large infrastructure projects than from textbooks or teachers' salaries.

So how badly does corruption actually affect growth?

Every year, since 1995, Transparency International has published a Corruption Perceptions Index (CPI). Using surveys reflecting the perceptions of business people and country analysts, the CPI ranks over 100 countries, from 0 to 10, the most corrupt to the least.

Using the Transparency International CPI, Graf Lambsdorff found that a one-point improvement in a country's corruption score was correlated with an increase in productivity of 4 per cent of GDP. This implies that were Tanzania (placed at 3.2 out of 10 on the 2007 Transparency International index) to improve its corruption score to the level of the UK (ranked 8.4 out of 10), its GDP could be more than 20 per cent higher, and net annual per capita inflows would increase by 3 per cent of GDP.

Joel Kurtzman found that every one-point increase in a country's opacity index (the degree to which a country lacks clear, accurate and easily discernible practices governing business, investment and government) correlated to a lower per capita income by US$986 and a 1 per cent decrease in net foreign direct investment as a share of GDP.[4] Moreover, corruption was also related to a 0.5 per cent increase in the country's average borrowing rate, and a 0.5 per cent increase in its rate of inflation.

Aid and corruption

The donor community is publicly airing concerns that development assistance earmarked for critical social and economic sectors is being used directly or indirectly to fund unproductive and corrupt expenditures (UNDP's Human Development Report, 1994). At a hearing before the United States Senate Committee on Foreign Relations in May 2004, experts argued that the World Bank has participated (mostly passively) in the corruption of roughly US$100 billion of its loan funds intended for development.[5] When the corruption associated with loans from other multilateral-development banks is included, the figure roughly doubles to US$200 billion. Others estimate that of the US$525 billion that the World Bank has lent to developing countries since 1946, at least 25 per cent (US$130 billion) has been misused. Vast sums of aid not only foster corruption – they breed it.

Aid supports rent-seeking – that is, the use of governmental authority to take and make money without trade or production of wealth. At a very basic level, an example of this is where a government official with access to aid money set aside for public welfare takes the money for his own personal use. Obviously, there cannot be rent-seeking without a rent. And because foreign aid (the rent) is fungible – easily stolen, redirected or extracted – it facilitates corruption. Were donor conditionalities remotely effective, this would not be the case. But, as described previously, conditionalities carry little punch.

In 'Do Corrupt Governments Receive Less Foreign Aid?', Alesina and Weder conclude that aid tends to increase corruption. Svensson shows how aid fosters corruption by reducing public spending; that by increasing government revenues, aid lowers the provision of public goods (things that everyone benefits from, but no one wants to pay for – for instance, a lamppost). In a similar vein, foreign aid programmes, which tend to lack accountability and checks and balances, act as substitutes for tax revenues. The tax receipts this releases are then diverted to unproductive and often wasteful purposes rather than productive public expenditure (education, health infrastructure) for which they were ostensibly intended. In Uganda, for example, aid-fuelled corruption in the 1990s was thought to be so rampant that only 20 cents of every US$1 dollar of government spending on education reached the targeted local primary school.[6]

Aid goes to corrupt countries

If it is so obvious, as it must be to everyone involved, that aid is vulnerable to such blatant manipulation, why is it that donors continue to donate?

Witness the occurrences in 1978 after the IMF appointed Irwin Blumenthal to a post in the central bank of what was then Zaire, now the Democratic Republic of Congo. Blumenthal resigned in less than a year, writing a memo which said that 'the corruptive system in Zaire with all its wicked manifestations' is so serious that there is 'no (repeat no) prospect for Zaire's creditors to get their money back'. Shortly after the Blumenthal memo, the IMF gave Zaire the largest loan it had ever given to an African country and over the next ten years President Mobutu's kleptocracy had received an additional US$700 million from the Fund.

More recently, referring to Zambia's former President Chiluba (who was in power between 1991 and 2002) in a parliamentary address in 2002, Zambia's current President, Levy Mwanawasa, alleged embezzlement and theft of up to US$80 million. Yet during the period when the thefts occurred Zambia had received upwards of US$1.5 billion from the World Bank. Much of the money was given under the auspices of the Heavily Indebted Poorest Country (HIPC) debt relief programme, a programme that required its beneficiaries to be corruption-free.

More generally, the academic Larry Diamond observes that development agencies continue to give aid to the most corrupt and unaccountable African states, with known authoritarian and corrupt governments. His list includes Cameroon, Angola, Eritrea, Guinea and Mauritania, each receiving aid equalling or even exceeding the African average of US$20 per capita. There is no end to it.

Why give aid if it leads to corruption?

Given what we know about foreign aid, and how it encourages and sustains corruption, why do Western governments insist on parcelling out aid to poor countries? Beyond the motivations for aid-giving discussed earlier – economic, political and moral – there are two other practical explanations why.

First, there is simply a pressure to lend. The World Bank employs 10,000 people, the IMF over 2,500; add another 5,000 for the other UN agencies; add to that the employees of at least 25,000 registered NGOs, private charities and the army of government aid agencies: taken together around 500,000 people, the population of Swaziland. Sometimes they make loans, sometimes they give grants, but they are all in the business of aid (the total of concessional loans – those which carry a small interest rate – and grants – effectively free money), seven days a week, fifty-two weeks a year, and decade after decade.

Their livelihoods depend on aid, just as those of the officials who take it. For most developmental organizations, successful lending is measured almost entirely by the size of the donor's lending portfolio, and not by how much of the aid is actually used for its intended purpose. As a consequence, the incentives built into the development organizations perpetuate the cycle of lending to even the most corrupt countries. Donors are subject to 'fiscal year' concerns: 'they feared the consequences within their agencies of not releasing the funds in the fiscal year for which they were slated' (Ravi Kanbur). Any non-disbursed amounts increase the likelihood that their subsequent aid programmes will be slashed. With the added corollary, of course, that their own organizational standing is placed in jeopardy.

For many donor agencies the decision to lend to less than reputable governments is couched in the view that if they didn't, the

poor would suffer, health and education budgets wouldn't be met, and countries would falter. The reality is, the poor aren't getting the money and, besides, even under the aid regime, African countries are faltering anyway.

Donors have the added fear that were they not to pump money in, poor countries would not be able to pay back what they already owe, and this would affect the donors' financing themselves. This circular logic is exactly what keeps the aid merry-go-round humming.

The insatiable need to lend is yet another reminder of why the conditionalities imposed on poor countries are worth no more than the paper they are written on. A 1992 study conducted by the World Bank's Operations Evaluation Department concluded that the release of aid tranches was close to 100 per cent, even when country compliance rates on conditions were below 50 per cent. Another World Bank study, in 1997, shows that between 1980 and 1996 72 per cent of the aid the World Bank allocated to adjustment lending went to countries with poor track records on compliance with conditionality. In the donor's desperate quest to lend, and maintain the lender–borrower see-saw, the aid relationship tips in favour of the corrupt government. Almost to the absurd point where the donor has a greater need for giving the aid than the recipient has for taking it.

Second, donors are apparently unable to agree on which countries are corrupt and which are not. A classic example of this occurred on 26 November 2002, when the *New York Times* published an article entitled 'Bush Plan Ties Foreign Aid to Free Market and Civic Rule'. The article trumpeted Washington's aid initiative and went on to outline the details of a White House proposal to set up a competition among the poorest world economies, where the 'winners' would be apportioned a slice of the US$5 billion foreign aid fund.

Curiously, among the list of possible qualifying countries was Malawi. Only weeks prior to the Bush announcement, Malawi's Ministry of Agriculture had been embroiled in a very public altercation with the IMF. Grain consignments had gone missing, and a sizeable percentage of Malawi's population was facing starvation. To make matters worse, a top Malawian official at the state-run grain marketing board who was to be a key witness in the two corruption cases 'mysteriously disappeared'.[7] Yet even with these allegations of corruption the US government did not see fit to remove Malawi from the qualifying Millennium Challenge Account list.

On the other hand, Tanzania was omitted from the same US Millennium Challenge Account list (apparently for reasons of corruption). But bizarrely it had been hailed as a model of good governance in November 2001 by the British government's Secretary of Development at the time, Clare Short, who promptly announced that Tanzania would benefit from a new pilot aid programme.

Who was right?

Thus, it would appear that regardless of who you are, and what you've done (or haven't for that matter), you'll get the cash from somewhere. In the Malawi maize scandal, the IMF resumed its lending programme to the government with no clear resolution of the case.

Corruption: positive or negative?

Maybe it wouldn't be so bad if African leaders, like some of their Asian counterparts, reinvested stolen money domestically, instead of squirrelling it away in foreign bank accounts.

This notion of 'positive' corruption goes a long way to explaining why many Asian countries, perceived to have high levels of corruption (in some cases, such as Indonesia, exceeding those of Africa), nevertheless post enviable levels of economic growth. For example, despite ranking just 3.5 out of 10 on Transparency International's Corruption Perceptions Index (2007), China continues to attract the greatest amount of foreign direct investment (US$78 billion in 2006, according to the IMF's International Financial Statistics), which undoubtedly has contributed to its

stellar growth. Similarly, although in the 1980s Thailand registered a strong economic performance, in the same decade it was ranked the most corrupt country in the world.

In stark contrast, corruption analysts estimate at least US$10 billion – nearly half of Africa's 2003 foreign aid receipts – depart Africa every year.[8] It is this 'negative corruption' which bleeds Africa's public purse dry, and does nothing to address the continent's desperate needs. It is truly tragic that while stolen aid monies sit and earn interest in private accounts abroad, the countries for which the money was destined have stagnated, and even regressed.

The cornerstone of development is an economically responsible and accountable government. Yet, it remains clear that, by providing funds, aid agencies (inadvertently?) prop up corrupt governments. But corruption is not the only problem emanating from aid. The deleterious effects of any new aid flows would be both social and economic.

Aid and civil society

Africa needs a middle class: a middle class that has vested economic interests; a middle class in which individuals trust each other (and have a court to go to if the trust breaks down) and that respects and defends the rule of law; a middle class that has a stake in seeing its country run smoothly and under a transparent legal framework; a middle class (along with the rest of the population) that can hold its government accountable. Above all, a middle class needs a government that will let it get ahead.

This is not to imply that Africa does not have a middle class – it does. But in an aid environment, governments are less interested in fostering entrepreneurs and the development of their middle class than in furthering their own financial interests. Without a strong economic voice a middle class is powerless to take its government to task. With easy access to cash a government remains all-powerful, accountable only (and only then nominally) to its aid donors. Inhibited in its growth, the middle class never reaches that critical mass that historically has proven essential for a country's economic and political success.

In most functioning and healthy economies, the middle class pays taxes in return for government accountability. Foreign aid short-circuits this link. Because the government's financial dependence on its citizens has been reduced, it owes its people nothing.

A well-functioning civil society and politically involved citizenry are the backbone of longer-term sustainable development. The particular role of strong civil society is to ensure that the government is held accountable for its actions, through fundamental civil reforms other than simply holding elections. However, foreign aid perpetuates poverty and weakens civil society by increasing the burden of government and reducing individual freedom.

An aid-driven economy also leads to the politicization of the country – so that even when a middle class (albeit small) appears to thrive, its success or failure is wholly contingent on its political allegiance. So much so, as Bauer puts it, that aid 'diverts people's attention from productive economic activity to political life', fatally weakening the social construction of a country.

Aid and social capital: a matter of trust

Social capital, by which is meant the invisible glue of relationships that holds business, economy and political life together, is at the core of any country's development. At its most elemental level, this boils down to a matter of trust.

As discussed earlier, among development practitioners there is increasing acknowledgement that 'soft' factors – such as governance, the rule of law, institutional quality – play a critical role in achieving economic prosperity and putting countries on a strong development path. But these things are meaningless in the absence of trust. And while trust is difficult to define or measure, when it is not there the networks upon which development depends break down or never even form.

Foreign aid does not strengthen the social capital – it weakens

it. By thwarting accountability mechanisms, encouraging rent-seeking behaviour, siphoning off scarce talent from the employment pool, and removing pressures to reform inefficient policies and institutions, aid guarantees that in the most aid-dependent regimes social capital remains weak and the countries themselves poor. In a world of aid, there is no need or incentive to trust your neighbour, and no need for your neighbour to trust you. Thus aid erodes the essential fabric of trust that is needed between people in any functioning society.

Aid and civil war

According to the Stockholm International Peace Research Institute, 'Africa is the most conflict ridden region of the world, and the only region in which the number of armed conflicts is on the increase.' During the 1990s there were seventeen major armed conflicts in Africa alone, compared to ten (in total) elsewhere in the world. Africa is also the region that receives the largest amount of foreign aid, receiving more per capita in official development assistance than any other region of the world.

There are three fundamental truths about conflicts today: they are mostly born out of competition for control of resources; they are predominately a feature of poorer economies; and they are increasingly internal conflicts.

Which is why foreign aid foments conflict. The prospect of seizing power and gaining access to unlimited aid wealth is irresistible. Grossman argues that the underlying purpose of rebellion is the capture of the state for financial advantage, and that aid makes such conflict more likely. In Sierra Leone, the leader of the rebel Revolutionary United Front was offered the vice-presidential position in a peace deal, but refused until the offer was changed to include his chairmanship of the board controlling diamond-mining interests. So not only would it appear that aid undermines economic growth, keeping countries in states of poverty, but it is also, in itself, an underlying cause of social unrest, and possibly even civil war.

While acknowledging that there are other reasons for conflict and war – for example, the prospect of capturing natural resources such as oil, or tribal conflict (which, of course, can have its roots in economic disparity) – in a cash-strapped/resource-poor environment the presence of aid, in whatever form, increases the size of the pie that different factions can fight over. For example, Maren blames Somalia's civil wars on competition for control of large-scale food aid.

Furthermore, in an indirect manner, by lowering average incomes and slowing down economic growth (according to Collier, both in themselves powerful predictors of civil wars), aid increases the risk of conflict.[9] In the past five decades, an estimated 40 million Africans have died in civil wars scattered across the continent; equivalent to the population of South Africa (and twice the Russian lives lost in the Second World War).

Beyond politicization of the political environment, aid fosters a military culture. Civil wars are by their very nature military escapades. Whoever wins stays in power through the allegiance of their military. Thus, the reigning incumbent, anxious to hang on to power, and manage competing interest groups and factions, first directs what resources he has into the pockets of his army, in the hope that it will remain pliant and at bay.

The economic limitations of aid

Any large influx of money into an economy, however robust, can cause problems. But with the relentless flow of unmitigated, substantial aid money, these problems are magnified; particularly in economies that are, by their very nature, poorly managed, weak and susceptible to outside influence, over which domestic policymakers have little control. With respect to aid, poor economies face four main economic challenges: reduction of domestic savings and investment in favour of greater consumption; inflation; diminishing exports; and difficulty in absorbing such large cash influxes.

Aid reduces savings and investment

As foreign aid comes in, domestic savings decline; that is, investment falls. This is not to give the impression that a whole population is awash with aid money, as it only reaches relatively few, very select hands. With all the tempting aid monies on offer, which are notoriously fungible, the few spend it on consumer goods, instead of saving the cash. As savings decline, local banks have less money to lend for domestic investment. Economic studies confirm this hypothesis, finding that increases in foreign aid *are* correlated with declining domestic savings rates.

Aid has another equally damaging crowding-out effect. Although aid is meant to encourage private investment by providing loan guarantees, subsidizing investment risks and supporting co-financing arrangements with private investors, in practice it discourages the inflow of such high-quality foreign monies. Indeed, in some empirical work, it is shown that private foreign capital and investment fall as aid rises. This may in part reflect the fact that private investors tend to be uncomfortable about sending their money to countries that are aid-dependent, a point elaborated on later in the book.

An outgrowth of the crowding-out problem is that higher aid-induced consumption leads to an environment where much more money is chasing fewer goods. This almost invariably leads to price rises – that is, higher inflation.

Aid can be inflationary

Price pressures are twofold. Aid money leads to increased demand for locally produced goods and services (that is, non-tradables such as haircuts, real estate and foodstuffs), as well as imported (traded) goods and services, such as tractors and TVs. Increased domestic demand needn't be harmful in itself, but a disruptive injection of money can be.

There are multiple knock-on effects. For example, take this very basic and simplistic story. Suppose a corrupt official gets

US$10,000. He uses some of the cash to buy a car. The car seller can now afford to buy new clothes, which places cash in the hands of the clothes trader, and so on and so forth down the line, at each point putting more pressure on domestic prices as there are now more people demanding more cars, clothes, etc. This is at least an example of positive corruption. But in a poor environment, there aren't any more cars, there aren't any more clothes, so with increased demand prices go up. Eventually, there may be more cars and there may be clothes, but by that time inflation will have eroded the economy, all the while with even more aid coming in. Perhaps ironically, because of the deteriorating inflationary environment more aid is pumped in to 'save the day'; we're back on the cycle again.

As if that was not bad enough, in order to combat the cycle of inflation, domestic policymakers raise interest rates. But, at a very basic level, higher interest rates mean less investment (it becomes too costly to borrow to invest); less investment means fewer jobs; fewer jobs mean more poverty; and more poverty means more aid.

Aid chokes off the export sector

Take Kenya. Suppose it has 100 Kenyan shillings in its economy, which are worth US$2. Suddenly, US$10,000 worth of aid comes in. No one can spend dollars in the country, because shopkeepers only take the legal tender – Kenyan shillings. In order to spend the aid dollars, those who have it must convert it to Kenyan shillings. All the while there are only still 100 shillings in the economy; thus the value of the freely floating shilling rises as people try to offload the more easily available aid dollars. To the detriment of the Kenyan economy, the now stronger Kenyan currency means that Kenyan-made goods for export are much more expensive in the international market, making the traded goods sector uncompetitive (if wages in that sector do not adjust downwards). All things being equal, this chokes off Kenya's export sector.

This phenomenon is known as Dutch disease, as its effects were first observed when natural gas revenues flooded into the Netherlands in the 1960s, devastating the Dutch export sector and increasing unemployment. Over the years economic thinking has extended beyond the specifics of this original scenario, so that any large inflow of (any) foreign currency is seen to have this potential effect.

Even in an environment where the domestic currency is not freely floating, but rather its exchange rate remains fixed, the Dutch disease phenomenon can occur. In this case, the increased availability of aid money expands domestic demand, which again can lead to inflation. Aid flows spent on domestic goods would push up the price of other resources that are in limited supply domestically – such as skilled workers – making industries (mainly the export sector) that face international competition and depend on that resource more uncompetitive, and almost inevitably they close.

The IMF has stated that developing countries that rely on foreign capital are more prone to their currencies strengthening. Accordingly, aid inflows would strengthen the local currency and hurt manufacturing exports, which in turn reduces long-run growth. IMF economists have argued that the contribution of aid flows to a country's rising exchange rate was one reason why aid has failed to improve growth, and that aid may very well have contributed to poor productivity in poor economies by depressing exports.

In other work, their research finds strong evidence consistent with aid undermining the competitiveness of the labour-intensive or exporting sectors (for example, agriculture such as coffee farms). In particular, in countries that receive more aid, export sectors grow more slowly relative to capital-intensive and non-exportable sectors.

Aid inflows have adverse effects on overall competitiveness, wages, export sector employment (usually in the form of a decline in the share of those in the manufacturing sector) and ultimately growth. Given the fact that manufacturing exports are an essential vehicle for poor countries to start growing (and achieving sustained growth), any adverse effects on exports should *prima facie* be a cause for concern.

Moreover, because the traded-goods sector can be the main source of productivity improvements and positive spillovers associated with learning by doing that filter through to the rest of the economy, the adverse impact of aid on its competitiveness retards not just the export sector, but also the growth of the entire economy.

In the most odd turn of events, the fact that aid reduces competitiveness, and thus the traded sector's ability to generate foreign-exchange earnings, makes countries even more dependent on future aid, leaving them exposed to all the adverse consequences of aid-dependency. What is more, policymakers know that private-to-private flows like remittances do not seem to create these adverse aid-induced (Dutch disease) effects, but they largely choose to ignore these private capital sources.

As a final point, in order to mitigate the Dutch disease effects (and depending on their economic environments), policymakers in poor countries generally have two choices. They can (in a fixed exchange rate regime) either raise interest rates to combat inflation to the inevitable detriment of the economy, or they can 'sterilize' the aid inflows.

Sterilization implies that the government issues bonds or IOUs to people in the economy, and in return they get the cash in the economy. Through this process the government can mop up the excess cash that aid brings in. But, as discussed later, even sterilization has its costs.

Aid causes bottlenecks: absorption capacity

Very often, poor countries cannot actually use the aid flows granted by rich governments. At early stages of development (when countries have relatively underdeveloped financial and institutional structures) there is simply not enough skilled manpower, or there are not enough sizeable investment opportunities, to put the vast

aid windfalls effectively to work. Economic researchers have found that countries with low financial development do not have the absorptive capacity for foreign aid. In countries with weak financial systems, additional foreign resources do not translate into stronger growth of financially dependent industries.

What happens to this aid money that can't be used? In the most honest of outcomes, if the government did nothing with the aid inflow, the country would still have to pay interest on it. But given the policy challenges of large inflows discussed earlier (for example, inflationary pressure, Dutch disease effects), policymakers in the poor country must do something. Since they cannot put all the aid flows to good use (even if they wanted to), it is more likely than not that the aid monies will be consumed rather than invested (as before, thereby raising the risk of higher inflation).

To avert this sharp shock to the economy, African policymakers have to mop up the excess cash; but this costs Africans money. In addition to having to pay the interest on the aid the country has borrowed, the process of sterilizing the aid flows (again, issuing local-country debt in order to soak up the excess aid flows in the economy) can impose a substantial hit to the government's bottom line. Uganda offers a telling example of this. In 2005, the Ugandan central bank issued such aid-related bonds to the tune of US$700 million; the interest payments alone on this cost the Ugandan taxpayer US$110 million annually.

Naturally, the process of managing aid inflows is particularly painful when the interest costs of the debt the government pays out are greater than the interest it earns from holding all the mopped-up aid money.

Aid and aid-dependency

Corruption, inflation, the erosion of social capital, the weakening of institutions and the reduction of much-needed domestic investment: with official aid to the continent at 10 per cent of public expenditure, and at least 13 per cent of GDP for the average country, Africa's continual aid-dependency throws up a host of other problems.

Aid engenders laziness on the part of the African policymakers. This may in part explain why, among many African leaders, there prevails a kind of insouciance, a lack of urgency, in remedying Africa's critical woes. Because aid flows are viewed (rightly so) as permanent income, policymakers have no incentive to look for other, better ways of financing their country's longer-term development. As detailed later in this book, these options, like foreign direct investment and accessing the debt markets, offer more-diversified and greater prospects for sustainable development.

Relatedly, in a world of aid-dependency, poor countries' governments lose the need to pursue tax revenues. Less taxation might sound good, but the absence of taxation leads to a breakdown in natural checks and balances between the government and its people. Put differently, a person who is levied will almost certainly ensure that they are getting something for their taxes – the Boston tea party's 'No taxation without representation'.

Besides, any rational government should be thinking about different forms of taxation as a way of running their affairs. In today's culture of aid-dependency, were aid to disappear (as unlikely as it seems), a country's tax-raising mechanisms would have atrophied to a point of incapacity.

Large sums of aid, and a culture of aid-dependency, also encourage governments to support large, unwieldy and often unproductive public sectors – just another way to reward their cronies. In his research, Boone (1996) finds that aid does increase the size of the government.

The net result of aid-dependency is that instead of having a functioning Africa, managed by Africans, for Africans, what is left is one where outsiders attempt to map its destiny and call the shots. Given the state of affairs, it is hardly surprising that, though ostensibly high on the global agenda, the Africa discourse has been usurped by pop stars and Western politicians. Rarely, if ever, are the Africans elected by their own people heard from on the global stage. And even though, as discussed earlier, the balance of power

may have shifted supposedly in favour of the African policymakers, it is still the donors who are in the policymaking driving seat (which might help explain why, over the last five decades, independent African policymaking and national economic management have diminished considerably). So aid-dependency only further undermines the ability of Africans, whatever their station, to determine their own best economic and political policies. Such is the all-pervasive culture of aid-dependency that there is little or no real debate on an exit strategy from the aid quagmire.

Aid objections

Dead Aid is not the first critique to be levelled against aid as a development tool. One of the earliest critics of aid was a Hungarian-born London School of Economics economist, Peter Bauer. At a time when the pro-aid model enjoyed wide support, Bauer was a lone dissenting voice, many of his writings drawing on his personal experience as a colonial officer studying the rubber industry in Malaysia and Nigeria. He saw what should have been flourishing industries wrecked by huge aid subsidies that rarely reached the indigent in the recipient country.

Aid, Bauer argued, interfered with development as the money always ended up in the hands of a small chosen few, making aid a 'form of taxing the poor in the west to enrich the new elites in former colonies'. Bauer argued most strongly that aid-based theories and policies were wholly inconsistent with sound economic reasoning and, indeed, with reality. Although he was a favourite of the British Prime Minister, Margaret Thatcher (she gave him a peerage[10]), at the time of his death in 1992 Peter Bauer was an outcast from the state-led socialist development agenda and his critique of the aid-based development strategy remained largely ignored.

More recently, the author and former World Bank economist Bill Easterly has provided numerous case studies on the failures of aid policies across the developing world. In *The Bottom Billion*, Paul Collier criticizes the blanket one-size-fits-all aid approach as paying no heed to the unique circumstances of individual countries, and thus proposes a more nuanced approach to aid-driven proposals, and only where they are needed.

Perhaps where all this literature falls down somewhat is that it does not explicitly offer Africa a menu of alternatives to aid. But, more importantly, the people who actually and actively implement the aid agenda are yet to be convinced. These are the people who are so wedded to aid that they are unable to see Africa as anything but helpless without aid intervention.

What follows is a discussion of other, better ways for Africa to finance its economic development; ways that have been tried and tested in places as far-flung as India, Russia and Chile, and even, closer to home, in South Africa.

PART II
A World without Aid