Assuring that Foreign Aid Is Effective
Raise the Level of Debate about Aid

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Summary

Presidential candidates can expect to encounter three competing concepts about foreign aid. They will hear that: foreign aid doesn't work and is therefore wasted; that poverty, disease, and hunger are so pervasive in the developing world that foreign aid must be increased dramatically; and that U.S. foreign aid decision-making and management are so complex and convoluted that they need major reorganization.

To raise the level of discussion and ground the administration's decisions in better data, the next President should direct several *evaluative* initiatives:

- All foreign aid programs should be systematically evaluated, based on their unique goals, rather than the overarching, sometimes irrelevant criterion of economic development
- Food aid policy, in particular, should be evaluated to determine its impact on hunger and on long-run agricultural development in recipient countries
- A consistent method should be established for comparing foreign aid efforts across developed nations that takes into account the contributions of private philanthropy and foreign-born workers' remittances to their countries of origin, not just government outlays.

The new administration should build on—and Presidential candidates should endorse—recent *programmatic* trends in foreign aid that reflect a bipartisan consensus. The administration should:

- increase well-conceived health and education efforts, because they are valuable on their own terms and promote economic development
- expand collaborations among federal agencies, with other countries, and with international institutions and non-governmental organizations, to reduce overlap and administrative burdens on recipient countries
- place World Bank lending on a more rational footing, by demanding concrete moves away from corruption both within the Bank and in recipient countries, and by limiting the implicit loan subsidy to middle-income countries, especially China
- continue the recent shift toward grants, away from loans.

The new administration should be skeptical of debt-relief proposals, especially those that do not include meaningful reforms, and should develop a comprehensive policy approach toward debt relief. Finally, even though the current organization of U.S. foreign aid operations is a morass, the new administration should refrain from reorganization until it determines clear objectives, forms a strong leadership team, and reviews the current system's strengths and weaknesses: "Think objectives and means first, reorganize later."

Context

Competing Beliefs

Judging from experience, three sharply contrasting ideas about foreign assistance will surface during the '08 Presidential campaign—and subsequent congressional debates:

- Foreign aid doesn't work and is therefore wasted
- Poverty, disease, and hunger are so pervasive in the developing world that foreign aid must be increased dramatically
- U.S. foreign aid decision-making and management are so complex and convoluted that major reorganization is needed.

The first two views are often expressed in highly emotional terms. The second viewpoint, notably, is sometimes manifested through mass marches, targeted demonstrations, and celebrity tours and performances.

Each of the three views is supported by substantial research. Most voters, though, are poorly informed about the size and scope of foreign assistance budgets and programs. In public opinion surveys, Americans grossly overestimate the amount the United States spends on foreign aid, especially compared with other countries.

Is Foreign Aid Effective?

If foreign aid is ineffective, it truly is wasted. A large research literature is devoted to determining the effectiveness of aid. *The central question is, effective in achieving what?* Much of the literature measures its effectiveness only in promoting economic growth, reflecting the assumption that foreign aid is primarily intended to boost economic development. In truth, economic development consumes about one-sixth of the President's FY 08 budget for international affairs, which includes State Department operations (Table 1). Some aid programs have economic aspects but are not designed solely to boost economic development (Table 2).

Foreign aid is a diverse endeavor, encompassing a bewildering array of programs, both bilateral and international. Many of these programs are intended to achieve goals other than economic development, such as fighting disease, supporting a friendly government, or providing disaster relief, and the United States is by far the largest donor of humanitarian aid.

It should come as no surprise that the universe of U.S. foreign aid programs, intended to serve multiple purposes, achieves only mixed results in meeting the single purpose of enhancing economic development. This is especially true when focusing on aid to a single country, such as the Democratic Republic of the Congo (formerly Zaire), where for many years bilateral aid was used essentially to bribe the corrupt and incompetent Mobutu regime.

TABLE 1. Portion of the President's FY 08 International Affairs Budget Devoted To Economic Development – selected programs

Item	Amount ($ billions)	Percentage
Development Assistance	1.0	2.8
Millennium Challenge Corporation (MCC)*	1.1	3.0
Multilateral Economic Assistance (including International Development Association of the World Bank)	1.8	5.0
Sub-total: Economic Development	*3.9*	*10.8*
Total FY08 Budget for International Affairs	**36.2**	**100.0**

*An additional $1.9 billion is requested for MCC funding in future years.

TABLE 2. Selected Foreign Aid Components Other Than Economic Development in the President's FY 08 Budget

Item	Amount ($ billions)	Percentage
Economic Support Fund (includes conflict recovery and counter-terrorism projects)	3.3	9.1
Foreign and security policy support for former Soviet bloc countries	0.7	1.9
Migration and Refugee Assistance	0.8	2.2
Sub-total: Selected Components	*4.8*	*13.2*

An additional problem in measuring the effectiveness of foreign aid in terms of economic growth is that much U.S. aid provides relief in the wake of war, famine, civil strife, or a natural disaster—when economic development already has experienced a serious blow and considerable time will be needed to regain previous economic levels. It is hardly fair to fault these relief efforts for failing to produce growth beyond previous levels, when countries are struggling to regain lost ground.

Efforts to Assess Effectiveness

Some aid programs nevertheless have been found to produce an economic development pay-off, particularly "short-impact" aid programs—including budget and balance-of-payments support, investments in infrastructure, and aid for productive sectors, such as industry and agriculture.

Attitudes toward the necessary pre-conditions for successful economic aid are evolving. Earlier research seemed to show that economic assistance does work in countries with sound economic policies, including fiscal discipline, an independent central bank that enforces anti-inflation monetary policies, and openness to international trade (the components of the so-called Washington Consensus). But, this conclusion has been largely discredited and replaced with a “neo-institutional” belief that the most important factor in economic development, whether or not foreign assistance is involved, is the quality of institutions. The Bush Administration combined the “good policy” and “good institutions” approaches in creating the U.S. Millennium Challenge Corporation, a new component of U.S. foreign aid programming.

Methodology Problems

The neo-institutional approach does not readily lend itself to econometric measurement. Indeed, it remains doubtful whether foreign aid can improve either economic policies *or* institutions in the developing world. The traditional approach of conditioning aid on policy and institutional reforms is itself questionable:

- Does “conditionality” work?
- When countries don’t meet aid agencies’ conditions, are penalties predictable enough to make “conditionality” credible?

The best measure of effectiveness might be whether a program accomplishes what it purportedly sets out to do, but aid agencies rarely get around to serious evaluation of individual programs. Evaluation requires a clear, comprehensive definition of effectiveness. Take, for example, food aid. Yes, it is fairly simple to show that food aid feeds the hungry. But, an effectiveness test also should include whether food provided *gratis* from outside the region undercuts local agriculture, and whether it leads to better nutrition for the local population over time, taking into account effects on local production. The analytical dilemma is exacerbated when the aid program becomes entangled with U.S. politics—in this instance, the desire to stimulate domestic U.S. agriculture. U.S. food aid programs normally require that food be shipped from the United States rather than purchased locally, thereby raising the cost and often undermining local agriculture and farm employment.

Despite these challenges, the next administration should emphasize serious evaluation in starting new assistance programs and in assessing inherited ones.

Are We Spending Enough?

Although the United States is the world's largest foreign aid donor in absolute terms, our contribution as a percentage of gross domestic product (GDP) is quite low. Under the OECD Development Assistance Committee's definition of foreign aid, which measures "Official Development Assistance" (ODA), the United States usually ranks either 26th or 27th among the 28 industrialized OECD member countries in the percentage of GDP devoted to foreign aid. As a result, critics say the United States is "stingy."

After declining in the early 1990s, U.S. foreign aid expenditures rebounded in the late 1990s and grew rapidly in the first half of the present decade. U.S. ODA has climbed from 0.12 percent of GDP in 1994-1995 to 0.20 percent in 2004-2005, while ODA for the European Union as a whole remained flat at 0.39 percent. U.S. aid to Africa has grown even more rapidly in this period, with a strong focus on HIV/AIDS (through the President's Emergency Plan for AIDS Relief) and a new focus on malaria. This rapid growth was helped by the fact that debt relief is now counted, rightly or wrongly, as ODA.

International comparisons are, however, weak. For one thing, the United States spends far more on *military* and other forms of non-ODA assistance than do other countries (a fact whose implications for development are controversial). Even more important, ODA comparisons take into account only expenditures by governments, and *private philanthropy* plays a far larger role in international aid from our country than from nearly all other OECD nations. U.S. private philanthropy for developing countries is more than twice as large as ODA. According to a Hudson Institute study, U.S. philanthropic sources gave more than any other donor country in 2005—even without taking into account contributions by U.S. corporations, universities, and religious organizations. However, most countries do not collect comprehensive data on private and voluntary giving that would enable more accurate international comparisons.

Remittances to home countries by foreign workers in the United States (some of whom are U.S. citizens) are also much larger than remittances from foreign workers in other countries, even on a *per capita* basis. Remittances from U.S. workers to developing countries are two and one-half times as great as the government's ODA. Although it is sometimes supposed that remittances go only from migrant workers to their families, the fact is that (in the case of Mexico, for example) groups of U.S. citizens and permanent residents of Mexican extraction have organized to send collective remittances to fund local infrastructure and local community projects in Mexican villages.

Under these circumstances, it's hard to justify cross-country comparisons, and efforts to paint the United States as stingy are off the mark. To make international comparisons truly valid and reliable, global criteria and data collection for both private philanthropy and remittances are needed to supplement data on ODA.

Choosing Among Different Types of Aid

Foreign aid is not a key political issue in the United States.[1] In general, it is easiest to win congressional support for aid programs with broad appeal, based partly on familiar U.S. models. To illustrate, the Bush Administration was able to increase total foreign aid by emphasizing health interventions that have been credited with success in the United States, especially for HIV/AIDS and especially for Africa, where the disease burden is horrific. Even though it is easier to garner support for programs like this, it would be short-sighted either to abandon abstract goals like economic development or to assume that what works in the United States will work in the developing world.

[1] The issue tends to be more important in northern European countries with proportional parliamentary representation; there, some minor parties hold strong positions on foreign aid, and coalitions are formed through compromises on party positions.

Programs can serve multiple purposes. Health programs—ranging from medical care to nutrition—promote economic development, because hungry children don't learn, and sick adults don't work. Indeed, health and education programs often do more to boost growth in countries with poor economic policies and poor institutions than do most economic development projects. More important, health programs have eliminated smallpox, dramatically reduced polio, and expanded immunizations and oral rehydration therapy, saving millions of lives. This is not to say that all health programs are worthwhile—on their own terms or in economic terms. Health programs require a sound distribution network and sufficient trained personnel to assure, for example, that medicine is properly administered and actually taken.

Similarly, education programs, by building human capital, can make a vital contribution to economic development. Yet, some education programs fail to achieve positive results in economic *or* education terms. In particular, programs that aim merely to increase the percentage of school-age children in places called schools can lead to simple warehousing of children—as in parts of India, where teacher attendance is strikingly low.[2]

Achieving economic development is elusive. Both donor and recipient countries struggle with a multiplicity of overlapping programs, some of which are too small to make a difference but overwhelm developing countries' administrative capacity. To avoid cluttering the landscape in developing countries, diverse government aid agencies and non-governmental organizations must combine or coordinate efforts. Meanwhile, even the best-intentioned programs and people may be unable to surmount deeply rooted systems problems, whether in health, education, agriculture, commerce, or other sectors. Given the complexities involved, it is not at all clear that the current level of public discussion in the United States or other developed countries is up to the challenge of devising a sound economic aid strategy.

[2] The UN Millennium Development Goal is to ensure that all children complete a full course of primary schooling.

Dealing with the World Bank

The Post-Wolfowitz Era

Issues surrounding the June 2007 resignation of World Bank Group president Paul Wolfowitz are likely to prompt the next administration to conduct a thorough review of U.S.-World Bank relations.[3] This reexamination could extend to regional aid institutions as well, but the World Bank is likely to be the main concern. Although the Wolfowitz controversy nominally involved conflict-of-interest issues, fundamental policy issues also were raised, and, since the resignation, even mainstream media coverage has turned from a focus on the man to an analysis of Bank governance and policies.

One issue is corruption—both within the Bank staff itself and in recipient countries. The new administration *must* address the staff dimension, because congressional appropriations help fund the Bank's soft-loan component, the International Development Association. And, the new administration also *should* address the local dimension, because corruption within countries goes straight to the function of the Bank, by compromising economic development. *At the end of the day, the Bank must be seen as willing to cut lending to countries that fail to measurably reduce corruption.*

Loans to Middle-Income Countries

Another key issue facing the Bank concerns global economic growth fueled by massive financial liquidity. Today, most of the Bank's middle-income member countries are able, in normal situations, to borrow in private financial markets. (In crises, nations turn to the International Monetary Fund.) Loans to middle-income countries could almost surely be turned over to the private sector. But, these nations currently obtain conventional loans, repayable in hard currency, from the World Bank Group's International Bank for Reconstruction and Development (IBRD). The IBRD has a credit rating of AAA, based on the willingness of the United States and other prosperous countries to stand behind the Bank's obligations—in effect, to guarantee the loans. The IBRD funds these loans by borrowing in private markets and investing its available

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[3] Wolfowitz was replaced by Robert B. Zoellick, former deputy secretary of state, in July 2007.

reserves. And, it makes money on this $15-billion lending operation, using the proceeds to fund staff salaries and day-to-day operations.

The issue is whether the United States should continue its implicit subsidy of World Bank loans to middle-income countries. The argument *against* it is that private-sector banks are able to serve this function. The argument *for* it is that the profits support World Bank staff salaries and services. These services assist not just "middle-income borrowers but others as well, so that lending to middle-income countries subsidizes aid to poorer ones. Further, these services include research, reports, and initiatives in the health and social sectors, many of which have global reach and therefore should be considered "global public goods."

Loans to Poor Countries

Less controversial are loans to low-income countries, mostly in sub-Saharan Africa. These low-income borrowers, heavily burdened by debt and poor governance, simply do not have the financial standing to satisfy the requirements of private lenders. They are usually able to borrow from the World Bank Group's International Development Association (IDA) at extremely favorable terms. They sometimes receive a grace period before payments begin and quite low interest rates. IDA activities on behalf of low-income countries are financed by triennial rounds of "replenishments" by the Bank's more developed member countries.

Loans to Emerging Countries

China, India, and other large developing nations pose another World Bank issue. These countries could borrow in private markets but also have hundreds of millions of people living in poverty, often in sub-national regions or enclaves (such as western China), where they constitute the vast majority of the population. As a device to reduce poverty, loans targeted to these groups would have considerable force. But, U.S. contributions to IBRD loans to China, in particular, could be hard to explain to American voters, given current trade imbalances and China's ability to access private credit. (China no longer receives IDA loans.) The new administration should address at least the China aspect of World Bank lending instead of allowing the issue to drift into contentiousness.

Providing Debt Relief

The cause of debt reduction for developing countries gathered strength with the Jubilee 2000 movement and other initiatives in the early 2000s to help developing countries, especially in Africa, free up resources for development. "Drop the Debt," one of the slogans of the cause, captures the emotional level of the public discussion. Much of this emotion was contrived or misdirected. For example, debt did not cause children to die, for even the most indebted countries received more aid than their debt service, and many of those countries were not servicing their debt. Further, debt relief involves new borrowing that creates new debt service obligations. Typically, debt relief is part of a package that includes relief of some portion of existing debt, payment of some remaining debt, and additional lending, which often exceeds payments on old debt.

In contrast to the public clamor, a quite different discussion was occurring between governments and inside the Washington Beltway among federal policy-makers and World Bank officials. This discussion focused on the potentially negative effects of debt relief on future aid levels. If debt relief would reduce future aid, it could impede development. Another adverse effect would occur if debt relief would end some recipient countries' laudable practice of making debt payments, called "reflows." If reflows stopped, the IDA would have less money to lend (and to compensate staff) and would have to rely almost exclusively on its triennial replenishments, which are difficult to coax out of the U.S. Congress and other political entities. Currently, reflows support one-fifth of the Bank's new soft loans to poor countries.

U.S. Leadership on Debt Relief

The debt relief issue came to a head at the Gleneagles, Scotland, G-8 summit in July 2005. There, the United States won G-8 support for comprehensive debt relief, including 100-percent relief for some countries, through an end-run around the

Europeans' advocacy of traditional debt relief packages, which included partial write-downs and new lending. The U.S. approach eliminated reflows from the countries receiving 100-percent relief, but only for IDA loans, not bilateral loans.

Why did the United States seek to exclude its own, bilateral loans from debt relief? As the Bush Administration recognized, debt relief is more a political than a financial matter. American politicians and diplomats have long been tempted to offer debt relief as a soft diplomatic option, to win hearts and minds in developing countries, even though its overall effect is mixed. To control this temptation, the government has for many years counted debt relief as an outlay in the federal budget "150 accounts," which fund international activities ranging from State Department salaries to bilateral economic assistance. Understandably, debt relief on bilateral loans was a sensitive issue within the U.S. foreign policy establishment.

Developing a New Policy

Debt relief can assist an overburdened developing country when it is accompanied by additional resources or induces domestic reforms. But, across-the-board debt relief is unlikely to help developing countries significantly. The new administration should develop a coherent policy on debt relief that would guide new lending to poor countries, especially in Africa where—Republicans and Democrats agree—more aid is needed. Debt relief is likely to be a recurring problem, and a new policy also would guide U.S. attitudes toward debt relief by international lending organizations, which have their own institutional and strategic interests.

Shifting from Loans to Grants

Architects of foreign aid used to view loans as a better device than grants, precisely because repayments could fund new loans and finance development agency staff costs. During the Bush Administration, though, following much international debate, a marked shift toward grants has taken place. Grants pre-empt the debt relief issue by avoiding a piling up of debt that, in many cases, is unlikely to be repaid. There is little reason for the new administration to reopen this issue.

Reorganizing Foreign Aid Programs

Every administration struggles with the question of how to organize U.S. foreign assistance efforts. Ever since the Kennedy Administration, major studies and reports on the subject have blossomed periodically. Bush Administration initiatives included:

- creating the Millennium Challenge Corporation, a quasi-independent agency, to reduce global poverty by promoting sustainable economic growth
- launching a major initiative to combat HIV/AIDS, and
- establishing a State Department office of Director of Foreign Assistance at the deputy secretary level to absorb many functions of the Agency for International Development, which remains in operation.

Is reorganization indicated? As the Brookings Institution's Lael Brainard has depicted, the organization of the federal government's foreign aid operation is a nightmarish maze of boxes and lines. A key, if cynical, reason to choose the reorganization route is that reorganizing is easier for new political executives than the nitty-gritty work of improving existing entities.[4] Nevertheless, there are ample reasons to refrain from reorganizing, at least initially:

- reorganization in government almost always makes things more, not less, complicated, especially when congressional action is required
- most reorganizations slow the pace of action, as new players are added, people move to new seats, new communications channels are put in place, and fresh bureaucratic rivalries take shape, and
- reorganization often substitutes for real action on concrete problems (following the maxim, "When in doubt, reorganize").

One reorganization idea is to create a cabinet-level department of foreign assistance, along the lines of the Department for International Development in the United

[4] For example, the Bush Administration found it easier to create the Department of Homeland Security than to wrestle with the inability of multiple departments and agencies to communicate quickly and cooperate effectively. Meanwhile, Congress has simply avoided addressing the nearly crippling problem of overlapping committee jurisdictions affecting homeland security.

Kingdom. This idea is almost certainly politically unworkable, since the Departments of State and Defense—and their Capitol Hill oversight committees—are unlikely to allow such a department to operate independent of their control. The idea is also conceptually flawed, because foreign aid serves multiple purposes, not just economic development, and some aid programs relate directly to national security.

Even if reorganization is eventually undertaken—which could consolidate and regularize some of the Bush Administration innovations—the new Administration should defer this task, pending fundamental decisions about primary foreign aid objectives, the formation of an effective leadership team, and a systematic evaluation of the current system's strengths and weaknesses. The advice here is: "Think objectives and means first, reorganize later."

About the Author and the Project

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Opportunity 08 aims to help 2008 presidential candidates and the public focus on critical issues facing the nation, presenting policy ideas on a wide array of domestic and foreign policy questions. The project is committed to providing both independent policy solutions and background material on issues of concern to voters.

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