2005

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Can Foreign Aid Save Africa?

By William Easterly (NYU), December 2005

Gordon Brown, the UK Chancellor of the Exchequer is compassionate about the first tragedy of Africa's poor: such as the millions of children dying from preventable diseases. He called for a doubling of foreign aid in January 2005. He offered hope by pointing out how *easy* it is to do good. Medicine that would prevent half of all malaria deaths costs only 12 cents per dose. A bed net to prevent malaria costs only $4. Spending just $3 on each new mother would prevent 5 million child deaths over the next ten years.

The year 2005 was the year that the West tried harder than ever to save Africa.[1] British Prime Minister Tony Blair called at the World Economic Forum in Davos in January 2005 for "a big, big push forward" in Africa to end poverty, financed by an increase in foreign aid.[2] Tony Blair commissioned a Report on Africa, which released its findings in March 2005, likewise calling for a "big push." Gordon Brown and Tony Blair put the cause of ending poverty in Africa at the top of the agenda of the G-8 Summit in Scotland in July 2005. Rock celebrity Bob Geldof assembled well-known bands for "Live 8" concerts on July 2, 2005 in nine cities around the world to lobby the G-8 leaders to "Make Poverty History" in Africa.

In July 2005, the G-8 agreed to double foreign aid to Africa, from $25 billion a year to $50 billion to finance the big push, as well as to forgive the African aid loans contracted during previous attempts at a "big push." Africa was already the most aid-intensive region in the world before the efforts of 2005. In September 2005, the world's leaders gathered at the United Nations to further discuss progress on ending poverty in Africa.

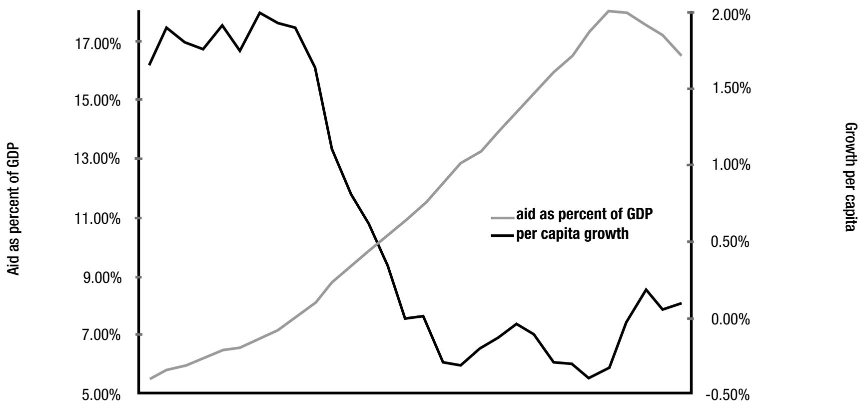
This aid came about because Africa's tragedy has been well known for a while. Sub-Saharan Africa contains 11 percent of the world's population, but produces only 1 percent of the world's GDP. In the median African nation, 43 percent of the population lives on less than a dollar per day (adjusted for purchasing power). Of the World Food Programme's list of 23 countries with more than 35 percent of the population malnourished, 17 of the 23 are in Africa.[3] AIDS and malaria kill the bulk of their victims in Africa. There are the long and brutal civil wars in Sudan, Angola, and Chad, not to mention Rwanda's genocide and the recent carnage in the Democratic Republic of the Congo (registering the world's highest war casualties since World War II). Related to war, seven of the eight recent cases of total societal breakdown into anarchy (known in the literature as state failure) in the world were in Africa: Angola, Burundi, Liberia, Sudan, Sierra Leone, Somalia, and Zaire/Congo (the other was Afghanistan).[4]

Life expectancy is another indicator that highlights Africa's tragedy, thanks to the double blow of high infant mortality and high adult mortality from AIDS. It is possible to pick a threshold for life expectancy (58 years) in which *every* African country is below that threshold and only a handful of other very dysfunctional societies elsewhere *(see the following map)*.

Life expectancy in 2001

The response of the West to Africa's tragedy has been constant throughout the years, from economist Walt Rostow and John F. Kennedy in 1960 to economist Jeffrey Sachs and Tony Blair in 2005: give more aid. Walt Rostow, motivated by acceleration of Cold War, called for doubling foreign aid in 1960; World Bank President McNamara called for doubling aid in 1973: the World Bank again called for doubling aid with end of Cold War in 1990. World Bank President Wolfensohn called for doubling aid with beginning of terrorist war in 2001. As just noted, G-8 Summit in July 2005 agreed to double aid to Africa. Aid to Africa did indeed rise steadily throughout this period (tripling as a percent of African GDP from 1970s to 1990s), but African growth remained stuck at zero percent per capita.

Figure 2: Aid and growth in Africa (10-year moving averages)



Another attempt to transfer resources to Africa is in the form of debt relief. Beginning in 1979, Africa had Paris Club reschedulings of debt, conversion of loans into grants, and replacing non-concessional loans with concessional loans. The debt relief effort intensified in recent years from the 1996 Heavily Indebted Poor Countries (HIPC) initiative to 1999 Enhanced HIPC to 100% Debt Cancellation at this year's IMF and World Bank meetings. Ironically, debt forgiveness was necessary because aid agencies' zero-interest, 10 year grace period, 40 year maturity aid loans did not generate enough to pay them back. The record shows that debt forgiveness has already been tried and it did not bring growth to Africa or even sufficient relief from debt.

Brown, Blair, and Sachs are silent about this second tragedy of Africa's poor. This is the tragedy in which the West has spent $568 billion on foreign aid to Africa over the past four decades and has still not managed to get 12-cent medicines to children to prevent half of all malaria deaths; The West has spent $568 billion on foreign aid to Africa and still has not gotten $4 bed nets to people to prevent malaria. The West has spent $568 billion on foreign aid to Africa and still has not got around to spending the $3 per new mother that would prevent millions of child deaths.

The key problem behind the second tragedy is that aid agencies and rich country politicians are not accountable to the poor for the results of their aid efforts: there is nobody motivated and responsible for delivering 12-cent medicines to poor malaria victims. Foreign aid agencies satisfy the demands of the rich public for feel-good moments, the feeling that "something is being done" about the first tragedy. The emphasis on aid *quality* lets aid agencies off the hook for actually delivering *results.*

There was a major incentive problem that contributed to the second tragedy. If all aid agencies and rich country politicians are collectively responsible for an objective, then individual agency's or politician's accountability for making progress towards the objective is non-existent. A very general objective (such as "saving Africa") weakens accountability because it is hard to disentangle the effect of aid from other factors.

Economists' theoretical models and empirical studies have very often guided the various efforts to have Western assistance rescue Africa. How has this literature fared in practice and how has it evolved throughout the years? What is the state of the literature today, and what does it suggest about how Western assistance can be most constructive in the future?

We will see three themes emerge from this review of the literature. First, contrary to the usual focus of economics, the literature on aid and Africa has paid inadequate attention to the incentives faced by the public and private participants in aid giving and receiving. Second, the literature displays a tendency (with some big exceptions) for old ideas to reappear and a seeming reluctance to learn from failures of the old ideas. Third, one big exception to the previous theme is that the literature shows continuing escalation of the recommended Western involvement, from less aid to more aid, from sectoral projects with few conditions to structural adjustment loans with many conditions, from concern with economic policies to concern also with democracy, corruption, and ending civil war, or in general, from less ambitious goals to more ambitious goals for Western assistance to Africa.

The lessons going forward from the first two themes are straightforward: pay attention to incentives, and reject old theories when they fail. The article will discuss the implication of these two lessons for the third theme: does a focus on incentives and learning from the past imply that the current goals of Western assistance to Africa are too ambitious? Do they imply that the West is too intrusive in Africa? Could foreign aid do better at some more modest tasks if it abandoned the more grandiose goals?

I. **Africa's Needs and Western response**

The bulk of Africa's countries rank low on standard international comparisons. African countries occupy most of the bottom places in income per capita, percent of population living in extreme poverty (less than a $1 a day), life expectancy, infant mortality, AIDS prevalence, literacy, and the UNDP human development index.

Africa is also a huge growth disappointment over the last 4 decades, with some of the worst growth rates in the world. (Of course, these indicators are related to each other conceptually and mechanically).

The West has responded to Africa's tragedy by intensive involvement of foreign aid agencies and international organizations. The average African country receives much more aid as a percent of its income than other developing countries and has spent more time in International Monetary Fund (IMF) programs.[5]

Of course, causality goes both ways between Western assistance and development outcomes in Africa. The West does more because Africa is poor, but its efforts are supposed to have a positive effect – to make Africa less poor. Does the still dismal level of the indicators today in Table 1 indicate a disappointing result of decades of Western assistance to Africa? A lot of the debate about the effect of Western assistance on Africa turns on untangling these directions of causality.

II. Theories and Evidence of the Effect of Western Assistance on Africa

The role of Western assistance in helping Africa escape poverty depends on one's theory of why Africa is poor. Economists over time have postulated different models of poverty that have differing implications for foreign aid.

1. The Big Push Models and Foreign Aid

Big push models say that Africa is poor because it is stuck in a "poverty trap." To get out of the poverty trap, they need a large aid-financed increase in investment, a "Big Push." Both the Harrod-Domar and the Solow growth models have been used to discuss the mechanisms of how a poverty trap arises.

The first mechanism is that saving is very low for people who are very close to subsistence (as would be predicted by a Stone-Geary utility function). In a closed economy, saving is equal to investment, so investment is also low. In the Harrod-Domar model with the capital constraint binding, growth of GDP per capita is simply a linear function of the investment (=saving) rate minus the population growth rate and minus the depreciation rate. If saving is too low to keep up with population growth and the depreciation of capital, then per capita growth will be zero or negative. Early development economists in the 1950s and 1960s postulated a desirable per capita growth rate and calculated the "investment requirement" to meet this target – the distance between the low domestic saving rate and the "investment requirement" was called the "Financing Gap". The role of aid was to fill the Financing Gap (Rostow 1960, Chenery and Strout 1966). Thus, this model predicted a strong growth effect for foreign aid through its role in boosting domestic investment above what domestic saving would finance.

Although this model soon went out of favor in the academic literature on development, it stayed alive in international organizations like the World Bank (despite occasional attempts to kill it off, such as in Easterly 1999). Current policy advocates for an increase in foreign aid to Africa have cited this model explicitly (Devarajan et al. 2002 at the World Bank, Blair Commission on Africa 2005, Sachs 2005). Jeffrey Sachs even argues: "success in ending the poverty trap will be much easier than it appears." He predicts that the increase in foreign aid and debt relief can end Africa's poverty in our generation.

This model shows the lack of attention to incentives that has plagued the aid literature. Even in a closed economy, saving depends not only on the distance from subsistence but also on the incentive to save depending on the rate of return to saving and investment. In an open economy, investment is not determined by domestic saving, but depends on the rate of return to investment. Private foreign investors and bank lenders will invest in the economy if returns are attractive enough.[6] Domestic investors will also compare the returns to domestic and foreign investments, as shown by Africa's extensive capital flight in which an estimated 39 percent of the stock of Africans' capital is held outside the continent (Collier, Hoeffler, and Patillo 2000).

In the Solow model, a strong relationship between income and saving rates could generate multiple equilibria at low and high levels of capital stock, reopening the possibility of a poverty trap. Again, the low domestic saving would not be a problem in an open economy in which investment responds to incentives. Kraay and Raddatz 2005 have shown that the relationship between initial capital and saving must follow an S-shaped curve to generate a poverty trap; they fail to find evidence for this shape in the data.

The other main mechanism to generate a poverty trap is some kind of nonconvexity in the production function in the Solow model. There may be strong external economies to investment, or there may be high fixed costs to investment projects such that a minimum threshold must be passed for investment to be productive. This idea was part of the inspiration for the original article that first proposed a Big Push (Paul Rosenstein-Rodan in 1943). This strand has had a longer shelf-life in the academic literature than the "Financing Gap" model because of the great interest of theorists in models with multiple equilibria (see for example the article by Murphy, Shleifer, and Vishny 1989). Sachs 2005 also emphasizes such nonconvexities in suggesting that Africa is in a poverty trap. However, Kraay and Raddatz 2004 also failed to find evidence for technological nonconvexities, while Easterly 2005 failed to find evidence in general for poverty traps at low initial income.

Nevertheless, Big Push models predict strong effects of aid on investment and growth. This prediction has been the subject of a vast empirical literature. The literature only really began to make progress when the severe problem of reverse causality was addressed with the use of political instrumental variables for aid flows. Boone 1996 was among the first to use such instruments and found zero effects of aid on investment and growth. Burnside and Dollar 2000 find that "aid raises growth in a good policy environment." However, Easterly, Roodman, and Levine 2003 find that applying the "new data test" i.e., adding new data unavailable to the original authors but keeping the same specification, the Burnside and Dollar finding no longer holds.

The most recent entries in this literature are Clemens, Radelet, and Bhavani 2004 (CRB), which finds positive effects of aid on growth, and Rajan and Subramanian 2005, which fails to confirm the CRB finding and in general finds a zero effect of aid on growth.

Casual observation, such as that summarized in the following table, makes it clear why one has to do some convolutions to the data to get a *positive* effect of aid on growth:

CRB was quoted to support the proposal to increase aid to finance a Big Push in Africa (for example, Blair Commission on Africa 2005, UN Millennium Project 2005). However, another feature of CRB's results contradicts the Big Push models

Country Category	Per Capita Growth, 1980-2002	Aid/GDP (%) 1980-2002	Percent of Time Under IMF Programs, 1980-2002
Ten Worst Growth Rates	-1.9	10.98	54%
Ten Best Growth Rates	3.8%	0.23	4%

– these models would predict increasing returns to aid, whereas CRB actually find diminishing returns to aid. CRB found an aid-squared term to be significant and negative, so the marginal effect of aid on growth in CRB turns negative at aid receipts over 8 percent of GDP – many African countries are already above this threshold and virtually all will be above it after the doubling of aid to Africa (Moss and Subramanian 2005). CRB's findings would actually imply there should NOT be the Big Push recommended by the Blair Commission and the UN Millennium Project. Such disjunctions between the use of research to support a proposal and the actual implications of the research are distressingly common in the literature on aid to Africa.

The aid and growth literature has suffered from the shortcomings of the cross-country growth literature – the specification of how aid affects growth and the selection of the other right-hand-side controls is pretty much wide open, and many of the specifications in the literature seem complex and not very transparent as to why they were chosen. This opens the door to data mining, which would manifest itself as a lack of robustness of aid and growth results.

2. Project interventions: education, health, and infrastructure

Another view of Africa's poverty was that it resulted from low human capital (poor health and education) and infrastructure. This emphasis began back in the 1960s but is still a major theme of explaining Africa's poverty. This emphasis beginning in the 1960s led to what may have been foreign aid's most productive period in Africa, when it invested in projects designed to achieve piecemeal, specific tasks like improving health, schooling, and infrastructure. Studies of such projects usually find a reasonably high rate of return, although there is the huge concern that these measured returns come from self-evaluation by those doing the projects along with not fully independent in-house.

Infant mortality is high in Africa, but has fallen significantly over the past 4 decades (see figure). WHO vaccination campaigns, the eradication of smallpox and river blindness, cheap treatments like oral rehydration therapy for infant diarrhea, and the spread of antibiotics contributed to success.

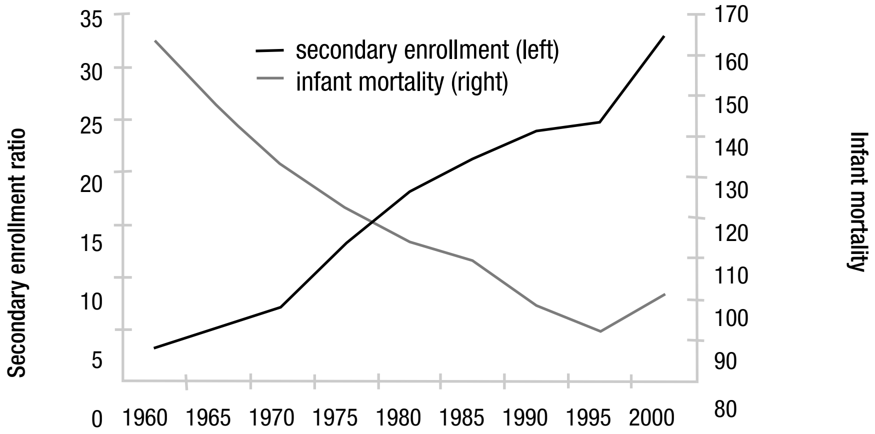
Education is also an area where there was some success. Both primary and secondary enrollments have increased sharply over their dismal levels at independence, although they are still comparatively low.

However, like the first approach to aid, the project approach to foreign aid underestimated the incentive problems with aid delivery. Teachers and health workers must be rewarded for good performance and penalized for bad performance to deliver good quality service. Health and education ministries must be motivated to get medicines and school inputs to the citizens. The donor bureaucracies themselves must have the incentive to make their projects work.

These incentive problems have been a major theme of the literature on health and education in Africa. While enrollments have expanded rapidly, the quality of education is hampered by missing inputs like textbooks and other school materials, weak incentives for teachers, corruption in education bureaucracies, and disruption of schooling by political events (Filmer and Pritchett 1997).

Likewise, in health, some of the initial progress has slowed, possibly due to corruption in the health system (studies in Guinea, Cameroon, Uganda, and Tanzania estimated that 30 to 70 percent of government drugs disappeared before reaching the patients) and the more complicated health problems that cannot be solved with routine methods (Filmer, Hammer, and Pritchett 2000, Pritchett and Woolcock

Good Education and Health Outcomes in Africa



2004). More complex health emergencies, like AIDS and malaria, have proved to be resistant to donors' efforts to contain them.[7]

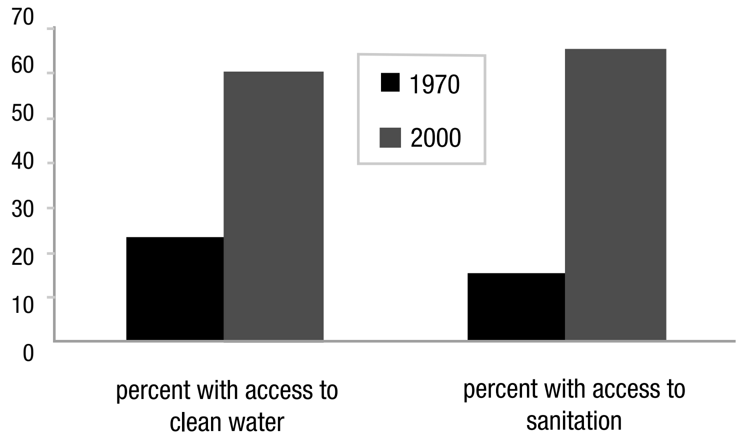
We see similar themes in infrastructure. Since independence, there has been much road building and expansion of electric generating capacity and water supply, supporting the idea that aid is more productive when directed to specific, piecemeal interventions. However, the incentive problems appear in this sector as well. There has been a chronic underinvestment in maintenance of infrastructure. For example, donors (and the recipient governments) have the incentive to build highly visible new roads, but less incentive to provide invisible maintenance. Infrastructure is now better than it was at independence, but still deficient for creating private incentives to invest.

Water supply and sanitation has been somewhat more of a success story (see figure), but even in that sector lack of maintenance causes boreholes to go out of service prematurely. I will examine to what extent, the literature provides systematic evidence to support the positive and negative aspects of this picture.

The underfunding of maintenance also reflects the donors' elusive goal of "sustainability" (best summarized by the cliché about giving a man a fish vs. teaching him to fish). Donors envision the local government taking over the project, which they think is necessary to make it last. This intuition was once appealing, but decades of experience show otherwise. As Kremer and Miguel (2003) argue, trying to make the project "sustainable" usually guarantees that it will *not* be "sustained."

Despite the problems, the stylized facts are consistent with a positive effect of aid on the availability of health services, education, and clean water and sanitation.

More good news: clean water and sanitation in sub-Saharan Africa



Although the sectoral outcomes could be much better if the incentive problems were solved, health, education, and water and sanitation are much improved over their state at independence. Can we confirm more systematically that aid was successful in fostering success in these areas? What could account for better results in aid in these areas than in others? There has been surprisingly little research on this question. I speculate that the incentives for donors could have been better because these were areas where success is more easily measured and where there is a more direct relationship between donor efforts and results (as compared to fostering growth, for example). As a result, donors could be held more accountable for results in these specific areas.

The new health emergencies of AIDS, as well as the persistence of malaria, has led to the call for much more extensive foreign aid to address health problems (World Health Organization 2001, Sachs 2005). The call is for some kind of crash program, with extensive top-down planning, to radically eradicate threats to health (another illustration of the theme of escalation of recommended aid efforts). These calls show little awareness of the incentive problems in health delivery (not to mention the incentives and information problems with top-down planning), and do not sufficiently appreciate the complexity of AIDS and malaria.

Despite the partial successes in expanding quantity of health, education, and water and sanitation, Africa's economic growth did not improve, which casts some doubt on the claim that human capital is the principal explanation for the Africa growth tragedy. There was little association, for example, between expanding education and economic growth (Pritchett 2001, Bils and Klenow 2002). Foreign aid donors were dissatisfied that these successes did not result in rapid growth in Africa. Critics argued that these inputs would not produce growth if the government mismanaged the economy as a whole. This led to the next escalation in Western assistance, the advent of structural adjustment lending by the IMF and World Bank, beginning in 1980.

3. Models of policies and growth

The structural adjustment programs came out of another view of why Africa is poor, and this gained prominence in the early 1980s with the advent of the "Washington consensus," and the pro-free markets arguments of people like the World Bank's chief economist, Anne Krueger. This view says that Africa is poor because its governments have chosen bad policies. Indeed, it seems obvious that many African governments pursued policies very destructive of economic development: artificially overvalued currencies, high black market premiums on foreign exchange, controls on interest rates that led to negative real interest rates for savers, drastic restrictions on international trade, and reliance on state enterprises. African observations often strengthened the results on the negative effects of bad policies on growth in the voluminous growth regressions literature. The "bad policies" view of Africa's poverty led to a different view of the role of aid. The role of Western donors and international institutions in this view was to induce changes in policy in Africa by making aid conditional on such changes. The structural adjustment loans (SALs) of the IMF and the World Bank were the embodiment of this approach. The objective of the SALs was "adjustment with growth" (Corbo and Fischer 1987).

How successful were these loans in facilitating "adjustment", i.e. changing policy? How successful was foreign aid in inducing better policies? The answer seems to be that Western donors and international institutions were not very successful in changing policy (Alesina and Dollar 2002, Burnside and Dollar 2000, Van de Walle 2001, 2005, Easterly 2005a).

How successful were the SALs in promoting growth? The growth and inflation outcomes associated with structural adjustment were dismal. Easterly 2005a picked out the African countries that were in the top 20 worldwide in the number of structural adjustment loans received from the World Bank and IMF. Most African countries that received intensive treatment from structural adjustment have negative or zero growth and some have high inflation (see table).

On balance, the outcomes associated with frequent structural adjustment lending

	Number of IMF and World Bank Adjustment loans 1980-99	Annual per capita growth rate from the date of first structural adjustment loan	Annual Inflation rate from first adjustment loan to 1999
Niger	14	-2.30%	2%
Zambia	18	-2.10%	58%
Madagascar	17	-1.80%	17%
Togo	15	-1.60%	5%
Cote d'Ivoire	26	-1.40%	6%
Malawi	18	-0.20%	23%
Mali	15	-0.10%	4%
Mauritania	16	0.10%	7%
Senegal	21	0.10%	5%
Kenya	19	0.10%	14%
Ghana	26	1.20%	32%
Uganda	20	2.30%	50%

are poor negative growth or high inflation, or both. Of course, there is a selection problem in that countries that are already in trouble were the ones that were chosen to receive these loans. However, it is hard to believe in a positive effect of structural adjustment lending despite the selection problem, for three reasons. First, things were so bad in so many recipients of structural adjustment that it stretches belief that it had a strong POSITIVE effect. Second, since structural adjustment loans were repeated year after year, one wonders why the patient did not improve after repeated doses of the medicine. Finally, formal statistical methods to control for possible reverse causality from crises to treatment still finds that structural adjustment lending had a zero or negative effect on economic growth (Easterly 2005a). Another influential recent study (Przeworski and Vreeland 2001) still finds that the effect of IMF programs on growth is negative, even controlling for the adverse selection effect. Another piece of evidence: African countries (even the "success stories" of Ghana and Uganda) couldn't pay back zero-interest Structural Adjustment Loans, and the World Bank and IMF had to forgive the debts through the Heavily Indebted Poor Countries (HIPC) initiative.

This dismal experience led to further rethinking of how aid could raise growth, even if it were unsuccessful at changing policy. A hugely influential study by World Bank economists Craig Burnside and David Dollar found that aid does raise growth in a good policy environment, although they also confirmed that aid had no effect on inducing good policies.[8] This suggested a different role for donors – they should not try to change policy, but they should be selective in choosing aid recipients, directing most aid to countries that had already achieved good economic policies on their own. Although Burnside and Dollar did not produce a model, they seemed to have in mind models that produce growth effects of aid, like those in the first section, with the welcome addition of policies that affect the incentive to invest the aid proceeds.

Burnside and Dollar did a growth regression on aid, with an additional interaction term between aid and good policy (measured by a composite index of low budget deficits, low inflation, and free trade). Their sample consists of six four-year time periods running from 1970-73 to 1990-93. In many of their tests, they found that when a country both got more foreign aid and had good policy, growth went up. They summarized (p. 847): "We find that aid has a positive impact on growth in developing countries with good fiscal, monetary, and trade policies but has little effect in the presence of poor policies."

The paper brought back the hope that aid could raise economic growth, which fed a policy recommendation to increase foreign aid, if only policies were good. President George W. Bush soon after announced a $5 billion increase in U.S. foreign assistance, about a 50 percent increase, and designed the increase to reward "good policy" countries.[9]

Unfortunately, the Burnside and Dollar study suffered from that curse of growth regression results, a lack of robustness and replicability. Easterly, Levine, and Roodman 2004 used the exact same techniques and specification as Burnside and Dollar, but added more data that became available since Burnside and Dollar did their study. They also hunted for more data in their original sample period (1970-93). Using updated and additional data, they did the same statistical exercise with four-year averages with the same control variables including terms for aid/GDP and the Burnside-Dollar policy index. They found no evidence in the expanded sample including new data that aid raised growth amongst countries with good policies, indicating a lack of support for the conclusion that "aid works in a good policy environment." A subsequent study by Rajan and Subramanian 2005 has also failed to confirm the Burnside and Dollar results. We are back to the pessimistic conclusion of the first section that there is no evidence that aid has effects on economic growth.

There were also other doubts about the policy and growth models in retrospect. Although policy changes were unrelated to aid intensity or to structural adjustment lending, there was a time trend towards better macroeconomic policies in Africa (as well as in all developing countries). African governments, with a few exceptions, moved away in the 1990s from extreme exchange rate overvaluations, extremely high premiums on foreign exchange in the black market, negative real interest rates, and high inflation (although there is no cross-country correlation with aid intensity, it may be that the donors contributed to the international climate of opinion among policy makers that contributed to these changes). Yet the growth response to policy reform was disappointing (Rodrik 2000, Easterly 2001b).

Separately, a new body of research suggested that bad macroeconomic policies may have only been a symptom of poor institutions (Acemoglu, Johnson, Robinson, and Thaicharoen 2002). Other research suggests that what looks like bad policy in Africa could be an optimal response to the local constraints – such as the inability to collect taxes from anyone who does not use the financial sector (Gordon and Li 2005). Supporting this view, studies that controlled for both policies and institutions' effect on development found strong effects of high quality institutions, but no additional effect of good policies like trade openness and low inflation (Rodrik, Subramananian, and Trebbi 2002, Easterly and Levine 2003).

Somewhat independently, aid donors and the International Financial Institutions were paying increased attention in the 1990s to institutional features like corruption, democracy, property rights, political violence, and regulation. These concerns became obvious as a number of African states became "failed states," whose problems it was difficult to argue stemmed just from poor economic policy choices. This led to yet a further escalation of donor involvement in Africa – the attempt to induce "good governance."

4. Aid, institutions, and development

A large literature on institutions and development suggests that Africa is poor because it has poor institutions – lack of property rights, dictatorship, weak courts and contract enforcement, political instability and violence, a hostile regulatory environment for private business, and high corruption. This view draws upon the seminal work of Douglass North and the vast literature he spawned. In order to end African poverty, in this view, the West needed to promote good institutions.

Ironically, one of the principal recent papers arguing for the institutions view of poverty argues that Africa's bad institutions are partly the result of the West's earlier intrusions in Africa. Acemoglu, Johnson, and Robinson (AJR) in a series of papers argue that colonization in Africa was unusually exploitative because the mortality rate facing Europeans was so high. Europeans wanted to get rich quick and get out of the "White Man's Grave," according to this theory. The Belgian Congo is well known as an extreme case of exploitation. According to AJR, the new independent states of Africa took over the extractive institutions out of the rulers' self-interest, with Congo/Zaire being again the classic example under Mobutu.

The AJR findings are otherwise debated in the literature, with serious questions about the quality of the data on European settler mortality rates (Albouy 2004), alternative explanations such as the high human capital of European settlers (Glaeser et al. 2004), and on the validity of the identification strategy. Another question mark about the "extractive colonialism" hypothesis is that historians of colonialism in Africa have generally not found evidence of large colonial profits for the metropoles (Dormois and Crouzet 1998, Fieldhouse 1982, O'Brien and Prados de las Escosura 1999). However, other authors have also found a strong effect of institutions on development due to factors other than settler mortality, such as distance from the equator, crop endowments, and ethnic fractionalization (Mauro 1995, Hall and Jones 1999, Easterly and Levine 2003, Rodrik, Subramanian, and Trebbi 2002).

These arguments could imply a rather pessimistic conclusion for aid donors – if institutions are determined by deep geographic, ecological, and historical factors, then what could aid do to help? This is partly a misunderstanding about what such results mean for policy. The factors like distance from the equator and crop endowments were chosen to identify the exogenous variation in institutions that could be used to draw causal inferences. They do not say that institutions are determined ONLY by exogenous factors, and hence do not imply anything about whether aid donors can influence institutions.

However, the concern is still valid that institutions could depend mainly on exogenous historical and geographic factors and not on anything aid donors can affect. Alesina et al. (2005) find that arbitrary colonial boundaries contributed to African institutions being worse than those in other continents. Mamdani 2000 and Iliffe 2004 argues that colonial practices of indirect rule worsened despotism in Africa. Nunn (2004) finds that the slave trade contributed to poor institutions in Africa. The "large natural resource curse" literature stresses the negative effect of oil and minerals (with which Africa is well-endowed) on institutions. Jensen and Wantchekon 2005 documented systematically the association of resource wealth with autocracy in Africa.[10] Jensen and Wantchekon show that new democracies have succeeded in Africa mainly in resource-poor places like Benin, Mali, and

Madagascar, while oil-rich states like Gabon and Cameroon still have the same dictators that have been in power for decades.

It is of interest, therefore, to examine the literature about aid and institutions, to see whether donors can still influence institutions at the margin. Three questions have received some attention. First, do donors give more to poor countries who have better institutions (e.g. more democracy, less corruption)? Second, does aid induce better or worse institutions? Third, how would outsiders engineer a transition from the present state of informal institutions towards more formal institutions?

The first question is relevant because donors widely assumed that aid would work better in countries with better institutions. The answer to the first question also affects the answer to the second. If donors give more aid to countries with better institutions, that would create some incentive for reformers in the recipient country to adapt better institutions. There is a large literature of "selectivity" of aid donors with respect to institutions. Alesina and Weder 2002 and Alesina and Dollar 2000 find no evidence that democracies or less corrupt states are rewarded with more aid.

This result reflects some of the egregious behavior of donors towards corrupt dictators, such as the $20 billion that donors gave to Mobutu in Zaire during his reign. These episodes are sometimes dismissed as a Cold War aberration. Has there been progress over time in "selectivity," since corruption and democracy are relatively new concerns for donors? In 1996 (the first year that data is available), there was no association between how much aid per capita a developing country received and its rating on the World Bank measure of corruption (controlling for other determinants of aid per capita, like per capita income and population size). Six years later in 2002, after much more public emphasis on corruption by donors, there was still no association between aid given to a country and how corrupt it was. Similarly, there was no association between aid given to a country and how democratic it was, either in 1996 or 2002, controlling for per capita income and population size, despite escalating rhetoric about democracy by donors.

The lack of a positive incentive from aid "selectivity" is a problem, because there are theoretical predictions that aid could also have *negative* effect on institutions. It may enable autocrats to perpetuate their hold on power, make rulers accountable to foreign donors rather than their own citizens. High aid revenues going to the national government benefit political insiders, often corrupt insiders, who have the incentive to oppose democracy that would lead to more equal distribution of aid. Aid increases the return to rent-seeking, which undermines many institutions (property rights, government efficiency, honoring contracts, etc.) Just as there is a "natural resource curse," there could be an "aid curse," for much the same reasons. Indeed, systematic evidence in several recent studies suggests that aid actually increases corruption, decreases democracy, and makes government worse.

Indeed, Svensson (2000) finds that aid increases corruption in ethnically fractionalized countries (which would mean most African countries). Knack (2005) finds that higher aid worsens bureaucratic quality, leads to violating the law with more impunity, and more corruption (controlling for potential reverse causality). Djankov, Montalvo, and Reynal-Querol (2005) similarly find that high aid caused setbacks to democracy over 1960-1999. They found aid's effect on democracy to be worse than that of the "natural resource curse."

Then there is the thorny question about how aid would practically go about changing institutions for the better in Africa. Without strong formal institutions, many market transactions create opportunities for opportunistic behavior such as non-delivery after payment, non-payment after delivery, "hold-ups" during some point in a transaction, defaulting on loans, failing to pay wages or pensions, and stealing from the enterprise or shirking labor. The research of Marcel Fafchamps (2001, 2004) has highlighted the dependence of African markets on self-enforcing networks of merchants to resolve problems of opportunistic behavior, with a counterpart theoretical literature such as Greif (1993) and Dixit (2004). The basic idea is that networks can permanently expel any member engaged in opportunistic behavior, creating a strong incentive not to cheat. In Africa, many networks form along ethnic lines, such as fish trading among the Luo in Kenya, retail trade among the Gurage of Ethiopia, long distance trade by the Hausa of Nigeria, and the domination of the formal business sector by Lebanese in West Africa, Indians in East Africa, and Europeans in Zimbabwe and South Africa.

The transition from informal to formal institutions is complicated. Attempts by Western aid agencies to introduce top-down formal institutions have not fared well in the complex maze of bottom up arrangements. Dixit (2004) has an interesting argument as to how introduction of imperfect rules-based institutions could actually make things worse, as they create outside opportunities for members of relationship-based networks. Network members can cheat their partners and then exit to operate in the rules-based system. A society could get caught in between informal and formal institutions, with neither working well.

There are similar doubts about introducing even such straightforward reforms as private ownership of land. The anthropologist Parker Shipton (1988) looked at the consequences of formal land titling for the Luo tribe in western Kenya in the early 1980s. He found that formal titles induced *more* uncertainty about property rights, since those with paper titles just added to the list of possible claimants under customary and formal laws. Ensminger (1992) finds similar results among the Orma of Kenya, and Berry (2001) among the Asante of Ghana. Goldstein and Udry 2004 find the land rights situation in Ghana to be so ambiguous – despite the existence of formal titling and land sales -- that women farmers do not leave land fallow (as would be optimal for land fertility) for fear of losing their rights to cultivate the land. Having two sets of rules is worse than having one. The transition from custom to well-functioning formal institutions is something that aid donors have to consider instead of just recommending some ideal norms for good institutions. The macro research findings on how "good property rights cause development" thus turns out to be complex to implement in practice.

Likewise, the idea of outside donors forcing democracy on countries is rather problematic. It is not obvious that non-democratic outside coercion is the optimal way to foster democratic practices. Fortunately, there has been an expansion of democracy in Africa which as we have seen cannot be attributed to aid and so does look like it is homegrown. This provides some hope for the process of local development of good institutions.

To close this section, I will note how in some aid recipients in Africa, institutional outcomes were particularly disastrous – civil war, genocide, anarchy, and "failed states." The IMF and aid donors were intensively involved in these countries before the collapse, but I will not attempt to solve the intractable analytical problem of how much the donors contributed (or mitigated?) the breakdown of the state.

I will just note in passing how the theme of escalation of aid efforts has recently gotten even more extreme. Now, some economists and other social scientists are suggesting ever more intrusive interventions in these failures, taking over sovereign powers of local governments – with economic incentives to end civil wars, international military peacekeeping forces, "post-conflict reconstruction," "neo-trusteeships," or "shared sovereignty." Economists have now created a large literature on the causes of civil war, studying "greed" vs. "grievance" as causes of civil war (Collier and Hoeffler 2002). Finding "greed" to be the dominant factor, the authors discuss how aid donors can manipulate financial incentives for combatants and how foreign actors can stabilize the situation after the civil war ends with some role in government. Taking a further step, political scientists James Fearon and David Laitin of Stanford wrote in Spring 2004: "the current, ad hoc and underrationalized arrangements ought to be reformed in the direction of neotrusteeship." In a similar vein, political scientist Stephen Krasner (also of Stanford) wrote in Fall 2004:

> Left to their own devices, collapsed and badly

governed states will not fix themselves because they have limited administrative capacity, not least with regard to maintaining internal security. … To reduce international threats and improve the prospects for individuals in such polities, alternative institutional arrangements supported by external actors, such as de facto trusteeships and shared sovereignty, should be added to the list of policy options. …De facto trusteeships, and especially shared sovereignty, would offer political leaders a better chance of bringing peace and prosperity to the populations of badly governed states.

There is nothing *a priori* to rule out that citizens of some African nations could prefer international administration to local corrupt autocrats or warlords. However, international peacekeepers do not have a great track record (see Rieff 2002), and it is surprising how confidently the aid policymakers use this new literature to make simplistic recommendations in very complex circumstances. The World Bank suggested in a 2003 report on how to end civil wars and restore peace.

> Countries can break this conflict trap by putting in place the policies and institutions necessary for sustained growth. Our new understanding of the causes and consequences of civil wars provides a compelling basis for international action. … Increased {foreign} aid and changes in allocation and administration could make such assistance more effective in preventing conflict… International action … could avert untold suffering, spur poverty reduction, and help to protect people around the world from … drug-trafficking, disease, and terrorism.

The report suggests that international military peacekeeping forces, reforms, and foreign aid can be half the risk of civil war in poor economies from 44 percent to 22 percent.[11]

I will not review the literature on civil wars, peacekeeping, and "neotrusteeships" in any detail. I just note this literature to show the extreme end-point at which one important strand of the aid literature has arrived after escalating the recommended intervention in African societies ever since independence (ironically ending at something resembling the pre-independence colonial regime). The failure of previous Western interventions in Africa is used as the rationale for even more intensive intervention.

5. Dysfunctional donors

All the attention in the aid and Africa debate is focused on Africa. But how effective were the donors in delivering valuable services to Africa? We have already seen some alarming signs of donor dysfunction. There are many more. Donors spent $2 billion over the last 20 years on roads in Tanzania. The roads did not improve. The principal output has been aid bureaucracy, with the Tanzanians producing 2,400 reports a year for the 1,000 donor missions who visit each year.

Democratically accountable bureaucracies are somewhat better at fixing the roads. When I lived in Takoma Park, Maryland, I called Kathy Porter, my city council-woman, to say that I had a pot-hole outside my house. Takoma Park Public Works came the next day and fixed the pothole, end of story. Things do not always work this well, but casual observation suggests roads in America are in vastly better condition than roads in Africa. Here's how a poor person in Tanzania would get a pothole fixed with the aid agencies, to give a very abbreviated version of the actual process. The national government solicits a "poverty reduction support credit" (PRSC) from the World Bank. To get a loan from the World Bank, the government must complete a satisfactory poverty reduction strategy paper (PRSP). The World Bank follows a series of internal steps to approve a PRSC, including the preparation of a Country Assistance Strategy (CAS). If the international lenders and donors approve the PRSP and release new funds to the national government, then government will allocate the money in accordance with the Medium Term Expenditure Framework (MTEF). If the pothole is still not fixed despite the PRSC, PRSP, CAS, and MTEF, and the poor person wants to complain, he is understandably at a loss –- nobody is individually responsible and accountable for fixing a pothole.

Even by bureaucratic standards, foreign aid bureaucracy is worse. Why? Perhaps it is because efforts and results in aid are largely unobservable, seen only by the voiceless poor. The lack of visibility on results makes aid bureaucracies unaccountable. Unlike private firms or democratic governments in rich countries, aid agencies do not face a "market test" or a "voter test". Africa's poor are political orphans: they have no voice or feedback on whether aid is helping them, and nobody is accountable to them.

III. The Micro Literature on Evaluation of Specific Interventions

The micro literature on development interventions adopts a completely different mind-set on aid to Africa from the "West saving Africa" paradigm. Eschewing these sweeping visions, this literature just seeks to evaluate the effect of some very specific interventions. The recent boom in the development literature on randomized controlled trials to evaluate development interventions suggests that some piecemeal interventions can do some good.

The Dutch aid organization International Christian Support Fund (ICS) distributed deworming drugs to schoolchildren in southern Busia district, Kenya. 92 percent of children were infected with intestinal worms that cause listlessness, malnutrition, and pain. Kremer and Miguel 2001 used a randomized approach in assessing the effects of deworming drugs. They studied the ICS programs that administered drugs and did worm prevention education for schools in Busia, Kenya. The project phased in the programs over three years, so there were three groups. In the first phase, Phase I schools could be compared to Phase II and III schools. In the second phase, Phase I and II schools could be compared to Phase III schools. They were able to identify a positive effect of deworming drugs on school attendance and a zero effect of deworming education on worm infection rates. The deworming drugs decreased school absenteeism by a quarter.

Banerjee and He 2004 gives other helpful examples that have been verified by randomized controlled trials as cost-effective uses of foreign aid: cash for education programs, de-worming drugs, dietary supplements like those for iron, Vitamin A, and iodine, education in using condoms and treating other sexually transmitted diseases to slow the spread of AIDS, indoor spraying to control malaria, fertilizer subsidies, vaccination, and urban water provision. None of these are keys to development according to some grand scheme; they are just modest interventions that make people's lives better.

IV. Conclusions

This review of the literature does not give a lot of grounds for hope that the West can save Africa. Either the various views of the roots of poverty in Africa were too simplistic, or the attempts to change these root causes underestimated the difficulty of doing so from the outside, or both.

The failure of the West's attempted rescue does not necessarily imply a disastrous outlook for Africa. Although beyond the scope of this review, I see no reason to dismiss the hope that Africans on their own will achieve economic and political changes that promote African economic development, and some of these changes are already happening (such as the movement towards freer markets and the expansion of democracy). There are hopeful signs of the growth of enterprise in Africa, such as the explosion of cell phones.

There are homegrown initiatives like Ashesi University in Accra, Ghana, "the Swarthmore of Ghana" which offers scholarships to half the entering class, started by a Ghanaian returning expatriate (although official aid agencies declined to support it). Programs to recruit and train the local people who are intended beneficiaries of aid, as well as local NGOs, to do evaluation and give feedback to government and aid agencies, to be "aid watchers" (a program like this in Benin is being started by NYU professor Leonard Wantchekon). In the end, economic development in Africa depends on African private sector entrepreneurs, African civic activists, and African political reformers . . . *not* on what ineffective, bureaucratic, unaccountable, and poorly informed and motivated outsiders do.

So what should Western aid do for Africa, if anything? Just because the West cannot save Africa does not logically imply that there is *nothing* the rich countries can do for Africans. The evidence in this review suggests that aid has been more successful at delivering tangible outcomes like education, health, and water. The micro development literature using randomized controlled trials also finds positive effects of some specific development interventions.

A more modest set of goals for foreign aid in Africa would make it easier (although not exactly easy) to hold aid agencies accountable for results. The sweeping ambitions of the current Western aid efforts in Africa do not lend themselves to accountability, since the outcomes depends on many other factors besides aid agency effort and attempts to isolate the effects of that effort have proved fruitless. More accountable aid agencies might be motivated to make more progress on some of the incentive problems of even the piecemeal interventions.

The more modest goals would also make the West much less intrusive in Africa, ending the historical tendency towards ever-increasing escalation of Western intervention in Africa. This seems like a good thing for many reasons. The intrusive Western role made African governments accountable to external actors instead of to their own citizens. Africans, like people everywhere, resent coercive foreign intervention. Insiders usually have better information and incentives to solve their own problems than outsiders do. Arguably, local democracy that facilitates citizen feedback has proven to be a more effective vehicle for good government than outside pressure. Finally, the more intrusive large-scale interventions have lots of unintended consequences that are hard to evaluate, many of which could be negative.

In short, the West cannot "save Africa," but rich country aid can still do good things in a piecemeal way to alleviate the suffering of some desperately poor people.

As F. A. Hayek wrote in his classic critique of expert-driven planning, "the success of action in society depends on more particular facts than anyone can possibly know." Hayek suggested "the curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." [12] The escalation of Western interventions in Africa shows an arrogance in the face of very imperfect knowledge.

Once economists discard arrogance, there is hope to hold donors accountable for such piecemeal outcomes as well-maintained roads, water supply, medicines, nutritional supplements, and textbooks, to improve the well-being of the poorest people in the world.

It is time to solve the second tragedy of foreign aid! It's up to people who care about the poor to hold aid agencies accountable for results. Foreign aid should go towards figuring out what works to help poor people with their most desperate needs, need independent evaluation and transparency. So that the next $568 billion of foreign aid to Africa does get 12-cent medicine to keep sick children dying from malaria, does get $4 bed nets to Africans to prevent malaria, does get the $3 per new mother that would prevent millions of child deaths, so that the next $568 billion of foreign aid to Africa does reach the poor.

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Footnotes

1 Following a very common convention, this paper means sub-Saharan Africa whenever it uses the name "Africa."

2 International Herald Tribune, Friday January 28, 2005, p. 1

3 http://www.wfp.org/country_brief/hunger_map/map/hungermap_popup/index.swf

4 As described by Richard Rotberg (2002)

5 Source: World Development Indicators of World Bank for aid and IMF for time in its programs. I use 1976 as the starting point because the last African colonies became independent in 1975.

6 The development economists of the 50s and 60s can be excused for neglecting this possibility given the underdeveloped international capital market of that era. There is much less excuse today, when many African countries had access to international capital markets beginning in the 1980s, and when the current lack of access is arguably more a function of the investment climate than any market imperfection.

7 Jeffrey Sachs and co-authors has argued that Africa's health is particularly disfavored by an ecology favorable to the most lethal kind of malaria. Skeptics wonder why donors and governments cannot respond by adopting fairly low-cost treatment and prevention of malaria. The colonial authorities controlled malaria successfully controlled in some places and periods. Utzinger, Tozan, and Singer 2001 discuss successful malaria control in the Zambian copper mining belt during the colonial period. Caldas de Castro et al. 2004 discuss a successful program to control malaria in Dar es Salaam before World War I.

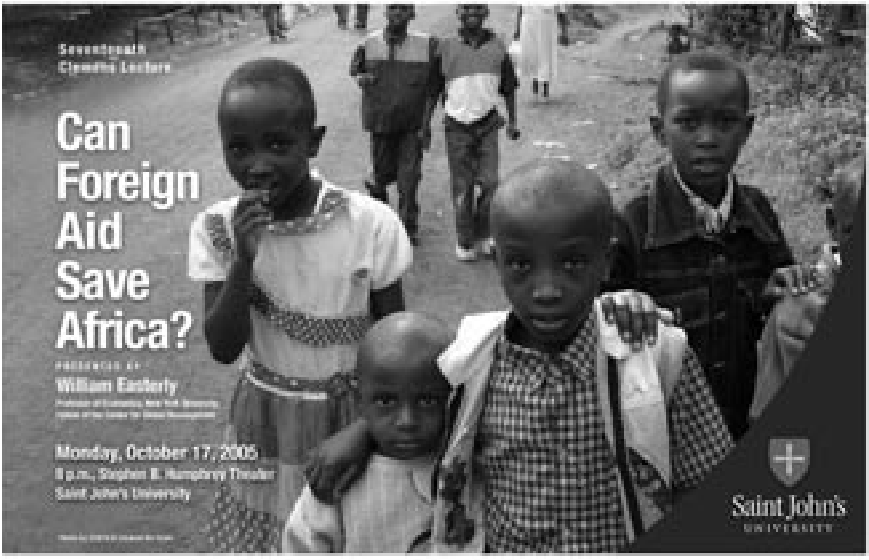
8 Burnside and Dollar (2000)

9 Another factor in the administration decision was the personal lobbying by the rock star Bono, who seems to be the most influential figure in the aid policy community.

10 See also Ross, 2001. Another study confirming this result is Collier and Hoeffler, 2005

11 World Bank, 2003, p. 168

12 p. 76, Hayek 1988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