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Halving Poverty by Doubling Aid: How Well Founded is the Optimism of the World Bank?

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Abstract

The article criticizes the World Bank as overy optimistic concerning its ability to raise the effectiveness of aid by concentrating aid on countries with "good" policies. It is shown that aid flows to the main recipient regions yielded the highest correlation to growth when their magnitudes shrank. It is argued that more aid can impair the quality of domestic policies in the recipients (endogeneity problem). The paper instead pleads for a shift of aid policies from country-oriented to issue-oriented aid. An international endowment fund under supranational law should help to finance such issues.

Keywords: Development aid; economic growth; poverty reduction; aid effectiveness; policy orientation, 'Dutch Disease' effects of aid

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1. INTRODUCTION

Over many years, the gap between the target rate of 0.7 per cent of OECD countries' annual GNP to be spent for Official Development Assistance (ODA) and the actual average rate for all donor countries (0.22 per cent in year 2000) has risen. In March 2002, donors, on the occasion of the UN International Conference on Financing for Development held in Monterrey, Mexico, decided to reverse the trend and narrow the gap. The US as the major donor responsible for dragging the average down to a historically low level promised to increase its commitments from 0.10 per cent to about 0.15 per cent by raising the core development assistance within the next three budget years by US$ 5 bn. EU member states committed themselves to raise their average ODA contributions from 0.33 per cent to 0.39 per cent until 2006. EU member states below the current average (such as Germany) announced to strive for at least reaching the average of 0.33 per cent. In total, the Monterrey Conference ended with additional commitments worth US$ 12 bn. This has been much below the additional US$ 40-60 bn. which the World Bank earmarked as necessary to achieve the so-called Millennium Development Goals, such as the halving of world poverty by 2015, and a far cry from the

US$ 100 bn. in extra aid per annum estimated by the British-based non-governmental organisation Oxfam (2002) as necessary.

Beyond the "guesstimates", there is the view that ODA has a signalling function at best and that other policies such as trade policies in OECD countries and developing countries, but more generally a sound, consistent and credible economic and institutional framework in the recipient countries are key prerequisites for higher growth and via growth for poverty reduction.[1] Large differences in growth rates between official concessionary flows on one hand and rapidly growing private flows to (relatively few) developing countries on the other hand underline the declining importance of ODA. Even if the 0.7 per cent target had been fulfilled throughout the nineties, the share of ODA in total net long-term resource flows to developing countries had anyway declined from about two thirds in 1990 to little more than 40 per cent ten years later. Furthermore, as it is the grant element which marks the essential difference to private borrowing, it is evident that the true grant content is much lower than the ODA amount if sizeable parts of ODA consist of loans rather than grants. Based on what is called effective development assistance (EDA) which takes only grants and the grant element of loans into

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[1] It is undisputed that “economic growth is essential for sustained progress on poverty reduction” (World Bank 2002: 16).

consideration, it can be shown that ODA values overestimate the true grant content by 25-30 per cent.

Thus, given the obviously limited role of aid in terms of magnitudes, what makes the proponents of doubling aid so confident that this would be a stepping stone to economic growth and poverty reduction? One argument could be that in the past the causality from rising aid to economic growth could be as clearly established as the causality from declining aid to declining growth. Both episodes could have happened, from 1970 to 1990 for the former link when aid per capita of recipients in poor countries grew in real terms, and from the early nineties onwards, when aid per capita shrank in real terms. Assuming that this causality could not be established, proponents could argue that policy barriers which worked against a success of aid in the past can be removed if allocation policies are changed. The main argument used in this context is that better quality of policies in recipient countries improves the effectiveness of aid so that shifting aid from countries with "poor" policies to those with "good" policies makes total aid more effective (Burnside, Dollar 2000). Better policies would also be instrumental to improve the effect of aid on poverty reduction while aid could strengthen the impact of "good" policies on growth (Collier, Dollar 2001).

In fact, it is argued that in the nineties there has been a clear improvement of the policy environment in developing countries (Burnside, Dollar 2000) which began at a time when aid levels declined. Allocation policies of multilateral donors in particular took these findings into account by refocusing aid on countries with "good" policies (World Bank 2002).[2]

The paper will address first the empirical coincidence of aid growth (or decline) with income growth (or decline) in those regions which are known to have been main recipients of aid. Furthermore, the paper will turn from region-specific correlation to the discussion of cross-country regression analyses which are the main tool in the literature to identify the causality from aid to growth (Section 2). In Section 3, the paper will discuss the validity of arguments of changing donor policies and/or changing policy environments which give rise to hope that the aid growth-income growth-nexus will be strengthened in the coming years. Section 4 stylises institutional alternatives to the current project-dominated aid allocation. Such alternatives are expected

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2 Should poverty be prevalent in countries with "poor" policies, the overarching target of maximising povery reduction under aid budget constraints would require to shift aid to these countries. However, because of the "poor" policies, diminishing returns of aid allocation would set in very early, hence justifying only moderate payments. In this respect, Chauvet and Guillaumont (2002) show based on cross-country regression analyses that if aid influences policy in a positive way, for instance by preventing reform reversals in vulnerable countries exposed to external shocks, then this effect is the stronger, the poorer the previous policy. Hence, the direction of policy changes from the past to the present should be taken into account when concluding on the effect of policy on aid effectiveness.

to help channel those resources into developing countries which are bottleneck factors to higher growth and thus less poverty without giving rise to changes in incentives and vested interests which impair growth. Section 5 concludes.

2. AID GROWTH AND INCOME GROWTH IN POOR REGIONS: A LOOK INTO THE PAST

In the following, poor regions are defined as Sub-Saharan Africa excluding South Africa[3] (SSA), North Africa (NA) and South Asia (SA). By the end of the nineties, the three regions received about half of net ODA. Figures 1-3 highlight the development of annual real aid per capita in the recipient regions and and real GDP per capita growth smoothened by ten-year averaging. The figures reveal extremely different patterns in the three regions. In Figure 1, real aid per capita received by SSA doubled between 1970 and 1999 but decreased during the last decade. Aid rose the most when the African economies faced severe economic crises in the aftermath of two oil price shocks. The coincidence between aid increase and economic decline between

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[3] As we touch upon the period from 1970 onward, South Africa has to be excluded from the sample because of non-eligibility for aid under the apartheid regime.

1970 and 1985 is not denied by the development financing institutions[4] but they deny the kind of causality which the late Lord Peter Bauer defended throughout his entire academic career, i.e., that aid makes countries poorer (Bauer 1972). Figure 1 also shows that aid declined in the period after 1990 when SSA enjoyed a slight recovery. This is also confirmed by the World Bank (2002: 71) when it is argued that the decline in aid flows came precisely at a time when the returns of aid increased rapidly.

The two other regions do not yield such a clear picture which could help to either support or reject the SSA pattern. In NA (Figure 2) mainly determined by the Egyptian performance, aid and growth by and large moved the same way: increases in the seventies, declines in the eighties and stagnation in aid accompanied by volatile growth in the nineties. In SA (Figure 3) dominated by the Indian performance, per capita aid flows declined since the mid eighties, however, without hampering growth. Hence, the experiences of the three regions suggest a distinct lack of robustness in the aid-growth nexus, both over time as well as between regions.

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[4] The World Bank (2002: 32) argues that "some developmentally successful countries… received large inflows during period of economic setbacks – creating a misleading statistical correlation between aid and poor economic outcomes. Natural disasters will produce a similar correlation. In both cases, analysis of the proper counterfactual would often show that, relative to what would have happened otherwise, aid has contributed to better outcomes".

It has been this puzzlingly diverse coincidence which motivated research to isolate the influence of natural endowment ("geography"), external shocks, domestic policies and remaining factors usually approximated by regional dummies on growth. Thus, the causality issue has been addressed by cross-country regression analyses from which "normal" patterns emerge. In such patterns which also include emerging markets as South Korea in order to have sufficient variance in country coverage, aid variables in interaction with proxies on policy quality explain economic growth.[5] Such proxies enter growth equations in addition to regional dummies and institutional variables such as ethnic fragmentarization. Regression coefficients are used to form policy indices which impact positively upon growth as interactive terms together with the share of aid in the recipient's GDP. The positive impact of aid under "good" policy indicators clearly emerges for multilateral aid. Bilateral aid, however, is more often given to countries with "poor" policies because of commercial or political interests. It is concluded from the

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[5] The above cited contributions of Burnside and Dollar (2000) as well as of Collier and Dollar (2001) stand in a long tradition of cross-country regression analyses on aid and growth which date back to the early seventies. Their basic finding ("aid works only in a good policy environment") was investigated by Dalgaard and Hansen (2001) as well as Hansen and Tarp (2001). They find out that if the aid-growth nexus is seen as non-linear rather than linear and if the vulnerability of regression results to the exclusion of outliers is taken into consideration one can conclude on a positive effect of aid on growth separately from the positive effect of good policy on growth. Chauvet and Guillaumont (2002) carry this research further by taking both the level and the change of policy in recipient countries into account as right-hand side variables.

regression analyses that the poverty impact of aid can be largely improved if aid reallocation is organized in a way that among recipients with similar policy quality funds flow to the poorer countries and that among recipients with similar poverty levels funds flow to countries with better policies (Collier, Dollar 2001: 1792–1793).

These findings support the view that reallocating aid in the past would have raised its effectiveness. What they do not show is that after such a reallocation Boone’s statement (1996) that aid had no positive effect on growth becomes meaningless. This raises questions about the transferability of the recent findings to the political conditions under which aid is allocated today.

3. NEW ERA, NEW CHANCES: A BETTER FRAMEWORK FOR AID IN THE NEW DECADE?

Judging from the past performance, the thesis that without substantially more aid given to poverty-ridden countries economic growth cannot catch up in order to fight poverty seems to hinge upon the policy quality in the recipients. Yet, as it is known from the past that aid was given to countries with "poor" policies, especially by bilateral donors which command the largest share of aid, one may fear that this allocation policy has not changed. To invalidate this fear, three arguments against the identity of past and present allocation

policies have been presented:

i. The Cold War distorted an efficiency-oriented distribution of aid. Countries were awarded because of their loyalty to the West regardless of whether they pursued good policies. The so-called poverty-reduction effectiveness of ODA tripled in the nineties thanks largely to the end of the Cold War (World Bank 2002: 70).

This argument can be discussed from two angles. First, in a neoclassical production function, the average factor productivity is always higher than the marginal productivity. Therefore, even if one could confirm the tripling of aid effectiveness, it is likely that this productivity increase cannot be sustained once aid volumes are doubled. Second, beyond decreasing returns to scale of additional aid, the Cold War argument must be qualified. The events of 11 September, 2001 have triggered the announcement of a "new war against terrorism" thus again leading to aid allocation for strategic rather than developmental reasons (Nestmann, Weder 2002). The point is not only that countries like Pakistan or other Islamic countries receive more aid irrespective of whether or not they change the camp from “good” to "poor" policies. It is more essential that for those countries with “good” policies it may be frustrating to see investment in security expenditures in so-called “frontier“ states with “poor” policies honoured by bilateral aid after 11 September,

2001, while just a year ago such expenditures were dismissed by the World Bank and other institutions as unproductive and as an issue of the well-known fungibility debate of aid.[6] Due to the change in assessment, vested interest groups in these countries can easily be rearmed in their opposition against "good" policies which hurt their special interests.

Notwithstanding the consequences of the events of 11 September, 2001, the assumption that aid allocation for strategic reasons has become an issue of the past seems naïve. For instance, in 2000 still, the Palestine Administration Areas (PAA) received almost six times as much in net ODA in per capita terms than the often praised success country Uganda though the lack of both sound economic policies in PAA and commitment to change to the better was evident. Even if one could share the optimism that multilateral aid institutions will no longer be taken as hostages by strategic interests of their shareholders after the Monterrey Conference, it is by no means guaranteed that some donors will not continue to give commercial or political interests priority over

[6] World Bank studies have shown that the "release" element of aid - in the sense that foreign aid supports government spending for other purposes - is high, so that the tax relief effect is low (Feyzioglu, et al. 1998). Boone (1996) has furthermore differentiated between low fungibility of aid for very poor countries receiving much aid in terms of their GDP and less poorer countries receiving less aid showing a higher fungibility.

developmental aspects in their bilateral aid.[7] The multilateral institutions are simply not in the position to tie the hands of their shareholders.

ii. Aid targeting, i.e. differentiating between countries with "good" and "poor" policies, has improved (World Bank 2002: xix).

The World Bank claims to be able to identify those recipients pursuing "good" policies and those doing less well. Furthermore, it contends that the aid allocation improved so strongly in the late nineties that the ratio between the per capita International Development Association (IDA) funding received by good-policy countries on the one hand, and poor-policy countries at the other hand rose from 2.4 in 1990 to 2.8 in the late nineties. However, the robustness of the findings to changes in the country sample is debatable. Focusing on the "outlier" problem which is also raised by Dalgaard and Hansen (2001) Nunnenkamp (2002), shows that two outliers with extremely high per capita aid receipts such as Cape Verde and Honduras have a strong impact upon group averages. If these two countries are dropped from a sample of countries with assumingly “good” policies, the average per capita

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[7] Riess and Grilli (1992) show that even within a fairly homogeneous group of donors like the EU member states with some sort of common developmental policy, differences in targeting bilateral aid either for developmental reasons or for commercial reasons have always been large.

receipts of aid in this sample fall below the per capita receipts in a sample of countries with assumingly "moderate" policies.[8]

iii. Aid reallocation in favour of countries with "good" policies does not lead to "Dutch Disease" and "crowding out" effects.

One major argument says that aid perceived by the recipients as a permanent transfer causes prices for non-tradables to rise faster than prices for tradables thus allowing the real exchange rate to appreciate (Dutch Disease effect). Domestic savings for precautionary reasons would shrink and consumption would grow. This would hurt the competitiveness of the tradable sector. In addition, aid would be channeled into the government sector thus increasing the size of governments (Boone 1996), crowding out the private sector and impeding economic growth. Country experiences witnessing this effect are rare simply because a massive concentration of aid on few countries (apart from disaster relief like in Mozambique) has not yet often occurred. Yet, Ghana which during the Rawlings administration became a showcase of

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[8] In assessing the stability of the composition of groups with different degrees of policy quality doubts, on the robustness arise if the recent development of countries like Zimbabwe ("moderate" policies in Collier, Dollar (2001: Table 3)) or Argentina ("very good"), to mention but few of them, is regarded. Whether an emerging country like South Korea which is far outside the target group of aid recipients or an advanced transformation country like Czech Republic both rated with "very good policies" should be included in such sample at all, can also be debated. Adding these countries to the sample of developing countries may serve the purpose of widening the intra-sample variance in cross-country analyses but this has to be paid by a loss of policy lessons to be learnt.

"good policy" orientation and received substantial support from multilateral donors, has been described as a "crowding out" example with rising government expenditures and "Dutch Disease" phenomena (Younger 1992).

If such phenomena would repeatedly emerge, a reallocation of aid on countries with "good" policies would face an endogeneity problem: As a result of an anticipated rise in the level of aid inflows, policies of the recipients would face a decline in quality just because of "crowding out" effects. Therefore, country differentiation by policy quality would become intertemporally unstable. Countries receiving more aid permanently would face strong temptations to operate more permissive and populist economic policies than in the past and make thus the country differentiation by policy quality intertemporally unstable. Given the institutional inertia in aid reallocation, the donors would not be able to change the country-wise distribution of aid as quickly as the policies in the countries change.

Figures 1-3 include graphs on the development of public sector expenditures in the three regions. Unfortunately, national account data from SSA countries (Figure 1) do not cover the entire period in order to discuss the argument of public sector expansion. For the 1985-1999 period it emerges that government expenditures as a percentage of GDP slightly rose parallel to the rise of real

per capita aid and declined just when aid flows began to decline. This would support concerns of a Dutch Disease effect. One can sharpen the crowding out argument by deducting public investment from the expenditures and thus concentrate on government consumption only. Here, it cannot be denied that since the seventies, government final consumption expenditure ratios steadily increased in SSA parallel to the rise of aid and also shrank after the mid-nineties when aid levels were no longer sustained. Burnside and Dollar (ibid: 863-864) associate the rise of government consumption in their cross-country regression analyses in particular with the importance of bilateral aid relative to multilateral aid. They argue that the allocation of the quantitatively dominant bilateral aid was much more determined by political targets than in multilateral aid and thus more prone to support "poor" policies. Again, in NA and SA, the patterns were different. In South Asia, declining aid levels did not deter government expenditures including consumption from rising parallel to the revitalisation of growth, while in North Africa it was more the SSA pattern which emerged. Hence, overall, there is some support for the "crowding out" argument.

The discussion raised above centers upon the questions of endogeneity and changing incentives. Has the quality of economic policies improved because of cutting aid in the past and/or would policy quality deteriorate just in those

countries which became eligible for more aid because of their positive ratings? Do time preference rates rise in recipient countries after being rated positively and are then national assets run down in anticipation that the threat of reversing the ratings is not credible? These questions raise doubts whether the multilateral donors have means to flexibly respond to a policy deterioration in sample countries. This is the more important as exogeneous events such as disasters may have strong poverty implications and may counteract a medium-term strategy to concentrate aid on countries with "good" policies.

iv. While dismissing both the so-called state-led approach of development in the fifties and sixties and the so-called market-led approach in the eighties and nineties, the World Bank now favours a melting of best elements from both approaches enriched by the dominant role of institutions. It is claimed that both donors and recipient countries have become increasingly aware of this overarching role in reducing poverty (World Bank 2002: 43).

In arguing this way, the World Bank ignores past insights. The decisive role of institutions and incentives was known during all periods of development co-operation. Otherwise, for instance, late Lord Peter Bauer’s early theses of the detrimental effects of aid could not have survived several decades and become revitalised (Easterly 2002). What was less known, however, were the

driving forces of selfish or benevolent behaviour of institutions as well as the causes and triggers of changes in behaviour. What is new today and what the donor community seems to treat with benign neglect, is the change in the relative weight between governmental institutions and non-governmental institutions (NGOs) in poor countries. In many poor countries, in particular in SSA, governmental institutions are in decay and the regional contagion of this decay is under way through various channels such as expulsion of migrants, mass exodus, ethnic cleansing, cross-border civil wars, ecological spillovers, and religious fundamentalism.[9] Private institutions can penetrate into this vacuum, from outside through donor countries' NGOs and/or from inside through a large variety of quasi-instititutions, sometimes including so-called stationary or roving bandits (Olson 1993) or ethnic fragmentarization (Bates 2000). If official aid, either project-oriented or programme-oriented, is traditionally channelled from public institutions in donor countries to public institutions in recipient countries, the decay on the recipient side may have serious implications for the quality of allocation unless one virtually stops aid disbursal as in the recent case of Zimbabwe. Thus, it does not come as a surprise that in recent years, new ways of allocating aid have been established, basically under the influence of Jeffrey

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[9] Such contagion may weaken the explanatory power of cross-country regressions in which clusters of neighbouring countries have a large weight.

Sachs (WHO 2001). These ways are destined to satisfy fundamental needs in health and nutrition, for instance, by giving multinationals in the pharmaceutical industry incentives to intensify research in the fight against tropical diseases. Such aid is decoupled from specific recipient countries and nevertheless addresses urgent needs in these countries.

In sum, geopolitical targets of allocating aid have not lost their relevance for bilateral donors. The rigid distinction between "good" and "poor" policies is conceptually questionable, intertemporally unstable and generally flawed because of the lack of taking endogeneity issues and the possibility of changing behaviour into consideration. Finally, poor countries suffering from public institutions in decay and from bad neighbourhood, require new approaches of channels of aid allocation.

4. NEW ERA, NEW CHALLENGES: OVERCOMING THE COUNTRY ORIENTATION OF EXTERNAL SUPPORT

The general doubts raised in this paper against the optimism of the World Bank concept are based on the perception that the country orientation of aid underlying this concept should no longer be taken for granted, at least not for very poor countries. Public institutions in these countries which are indispensable to ensure an efficient allocation of external aid funds have

become increasingly fragile, failing and fading. Their high vulnerability does not allow to extrapolate temporary episodes of satisfactory governance into the future.

This sceptical assessment does not belittle potentially positive effects of external support on income generation in very poor countries. But it raises doubts that the direct transmission channel via the government of the recipient country is the most appropriate way to help the poor. Indirect ways seem more promising provided that they address the most urgent needs of people living in poverty. Aid should, for instance, focus on easing bottleneck factors whose social rates of return can be shown to exceed the private rates, possibly research and research implementation in areas like health, nutrition, education, institution building, IT infrastructure, and public management. These tasks are of a long-term nature. They are geographically or regionally specific rather than country-specific. Furthermore, they are decoupled from special interests of individual donors. Each donor can subscribe to them. Therefore, there are cases for setting up a multilateral capital stock to be established financed both by donors and recipients (to a smaller part) through mandatory contributions. These contributions would be fixed by an international treaty and thus be no longer subject to annual budget talks in the

donor countries.[10] The fund would be endowed with fresh capital from the donors and debt service flows from the recipients. It would be managed by private capital market institutions under the supervision of the fund owners and subject to international law. Revenues from the capital stock would be available for financing development targets to be defined by the owners of the fund. The fund should buy existing knowledge and the expertise on the above issues and provide financial means to expand the knowledge frontiers by incentives for private research. Developing countries could draw on the stock of knowledge available in the fund by paying market prices for services supplied out of the fund. Such payment could be in local currency and subsequently also local knowledge on the above issues should be made available in the fund.

The principal target underlying the fund is to support the spillover of present and future knowledge on improving living conditions and chances for income generation in developing countries. It is essential not to exhaust the capital

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10 Kanbur et al. (1999) propose "common pools" to finance public international goods. While such pools are targeted towards the same type of goods and services of mutual benefits for donors and recipients which are described above, they differ from our proposal with respect to the allocation principles. The Kanbur proposal departs from a single development strategy of each recipient guiding all donors. They would pay into a pool to complement the recipient's budgetary resources thus bringing project aid to an end. Our proposal, however, earmarks funds in the capital stock not for countries but for programmes which indirectly will benefit the very poor. Institutionally, our capital stock would be established apart from the normal aid budgets of donors and come close to an international endowment fund subject to international law.

stock but to live from its revenues, to have a long-term perspective of fund management beyond the annual national budgets, and to decouple the fund from narrow country-specific projects or policies. Instead, issues should have at least a regional perspective if not a global one. Human capital stock formation would have absolute priority over physical capital stock formation. The ups and downs of policy quality in poor countries would not become the essential criterion of fund allocation.

Notwithstanding the establishment of a global capital stock, a number of policies usually enumerated under the label "policy coherence" can largely help to raise the effectiveness of a given aid volume. To start with the donor's side, revitalising economic growth particulary in Continental Europe and minimising monetary shocks would not only stimulate world demand for aid recipient's exports but would also facilitate the search for appropriate exchange rate regimes in poor countries which suffer primarily from the volatility between the exchange rates of the three leading currencies. In trade policies, the opening of markets to products from developing countries and the phasing out of distortionary domestic policies in agriculture in OECD countries unfortunately has become a "ceterum censeo" without a significant breakthrough so far. Estimates of the gains from trade liberalisation mostly exceed the 50 bn US$ which is the benchmark for aid expansion. In recent

years, the claim for trade liberalisation in OECD countries includes trade in labour-intensive services which require the temporary presence of natural persons in the service-consuming country (so-called mode-4 supply in the Geneva Agreement for Trade in Services). Post-Marrakesh negotiations have shown that OECD countries are most restrictive in liberalising mode-4 services in order to discourage the circumvention of restrictive migration policies. Estimates on gains from working abroad are much rarer than those on gains from goods trade but conservative estimates yield that immigration controls deny developing countries income of at least US$ 250 bn. a year (UNDP 1992: 58).[11] Policy coherence issues should also address export guarantee schemes in OECD countries which provide incentives to implicitly subsidise exports of capital-intensive goods and distort factor prices in the recipient countries to the detriment of unskilled labour.

Coherence issues on the recipient side include the need to reduce both inconsistency between domestic policies at a given period (fiscal policies, trade policies, wage policies, capital market policies) and of specific policies over different periods (time inconsistency, lack of credibility). Furthermore,

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[11] The same studies yield that if 2 per cent of the labour force in the developing would choose to move each year and the migrants would earn no more than the poverty-line income in industrial countries they would earn US$ 220 bn. a year. Of this, between US$40 bn and US$ 50 bn would be sent to the home countries as remittances (ibid: 58).

protection levels in developing countries are generally higher than in OECD countries as a heritage of infant industry arguments. They act as an implicit tax on exports and discourage trade among developing countries.

5. CONCLUDING REMARKS

The message from the above findings is that raising aid effectiveness is not primarily a matter of shifting funds from countries with "poor" policies to countries with "good" policies. Policies changes may be volatile in both directions, and due to the inertia of the international donor policies, fund reshuffling may not be able to follow suit. Endogeneity problems may induce countries with a good rating to become more permissive in their policies once they become eligible for more funds. Finally, geopolitical targets may reemerge after the end of Cold War in the aftermath of the events of 11 September 2001. Raising aid effectiveness is a matter of improving the framework conditions, of setting new priorities and of finding new operational means. The priority is poverty reduction and the way to this target is paved with the cornerstones labeled new technologies for health, education, public management and information dissemination. Research dedicated to the needs of poor people is deficient, and here is an area of action with high social returns. To understand this area as a long-term endeavour, the funding of knowledge formation and dissemination should be decoupled from the

political uncertainties of annual budget talks in donor countries. Therefore, an endowment fund has been proposed as an example which should be managed by private capital institutions outside the public aid budgets. The fund would invest its means and use the revenues for the above purposes.

It is appropriate to underline that any empirical evidence from aid increase to poverty reduction based on cross-country regression analyses cannot be reliably extrapolated into the future. While we do not know which institutional entities in the developing world will be on the world map of the deadline year 2015, we perhaps know more about the essential challenges facing the living conditions of poor people in the developing world by that time. If this knowledge is clouded for the time being, it would be good investment to spend continuously more funds on expanding the knowledge frontier than today.

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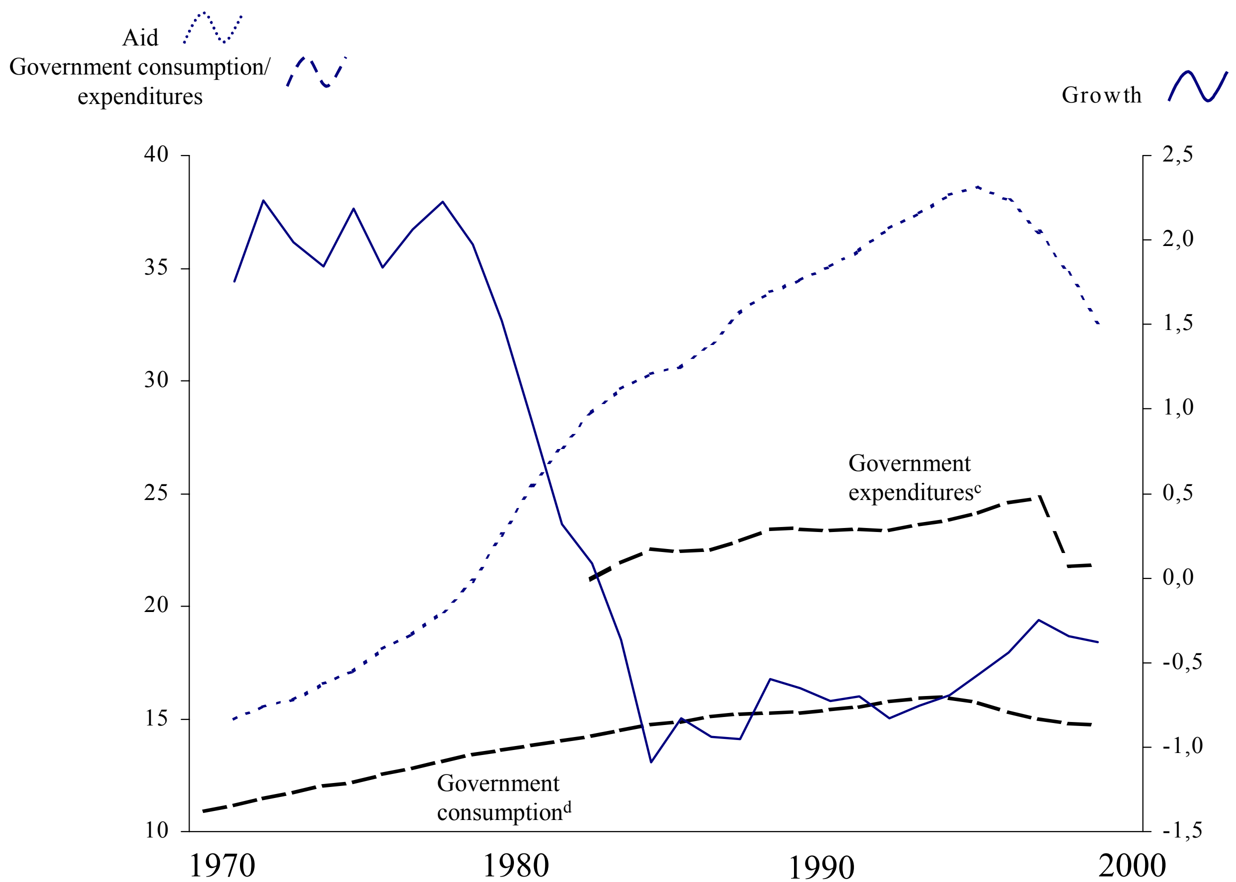
Figure 1 – Aid and Growth[a] in Sub- Saharan Africa[b], 10 year average



a Aid = Official development assistance and official aid per capita in real terms (deflated
by US GDP deflator 1995 = 100)
Growth = Real annual GDP per capita growth

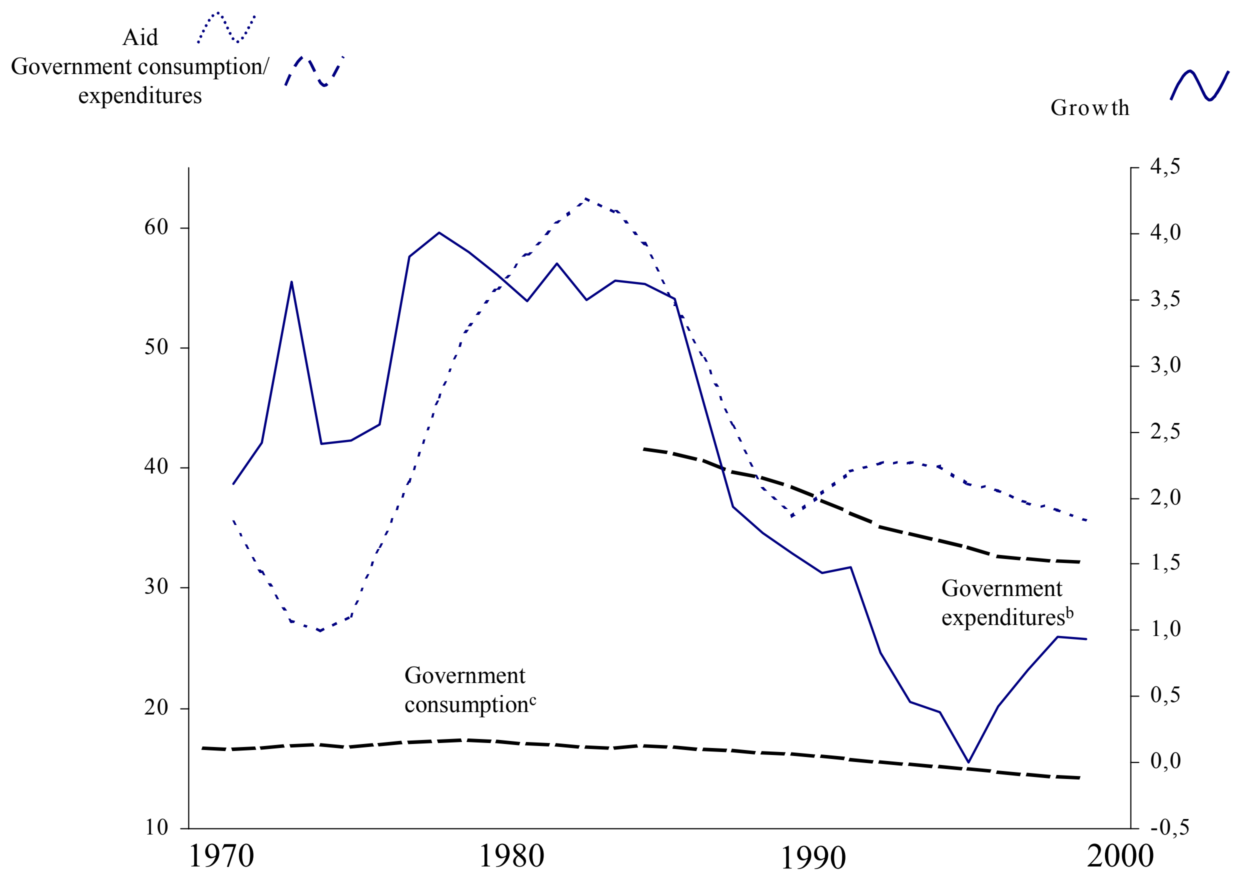
b excluding South Africa

c Government expenditures (per cent of GDP)

d General government final consumption expenditures (per cent of GDP)

Source: World Development Indicators CD-ROM 2001. Own calculations.

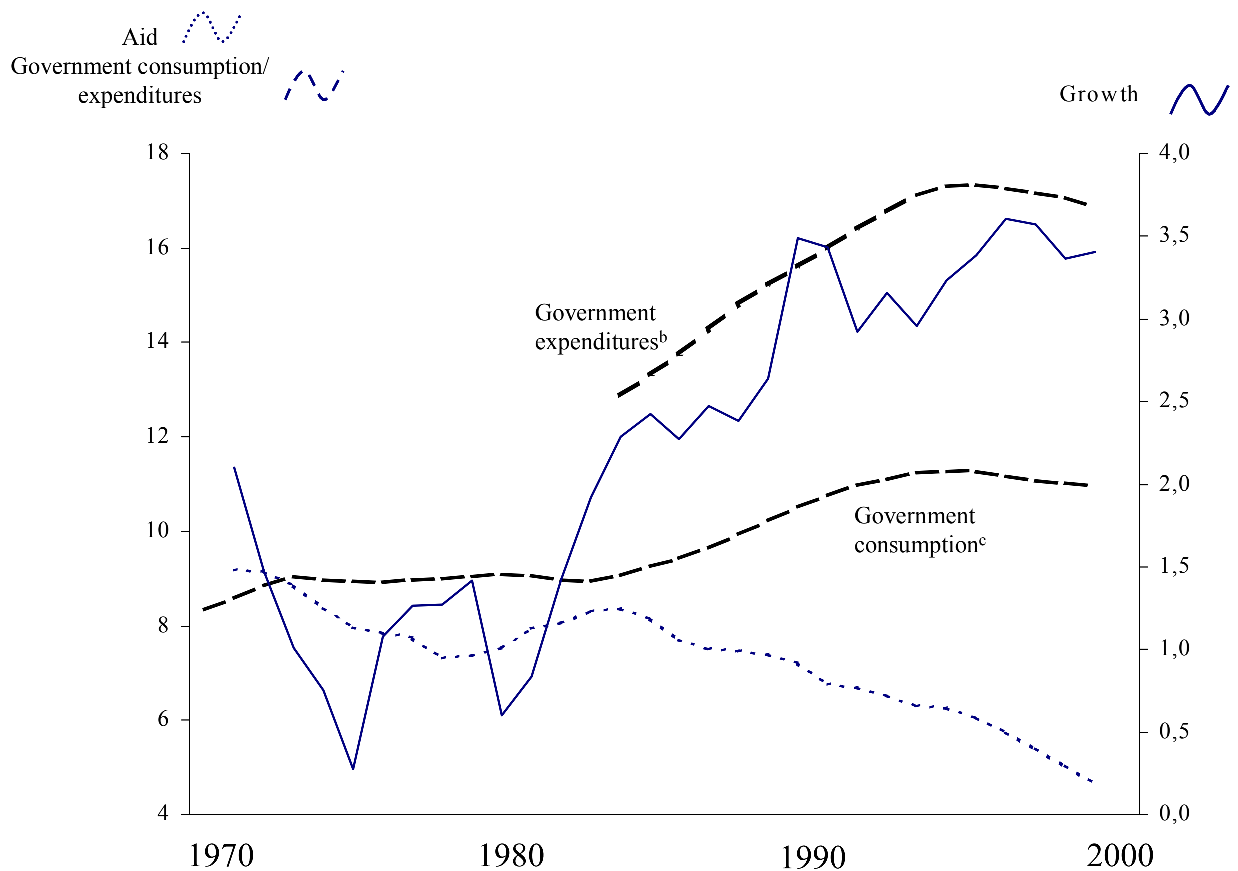
Figure 2 – Aid and Growth[a] in North Africa, 10 year average



a Aid = Official development assistance and official aid per capita in real terms (deflated
by US GDP deflator 1995 = 100)
Growth = Real annual GDP per capita growth
b Government expenditures (per cent of GDP)
c General government final consumption expenditures (per cent of GDP)

Source: World Development Indicators CD-ROM 2001. Own calculations.

Figure 3 – Aid and Growth[a] in South Asia, 10 year average



a Aid = Official development assistance and official aid per capita in real terms (deflated
by US GDP deflator 1995 = 100)
Growth = Real annual GDP per capita growth.

b Government expenditures (per cent of GDP)

c General government final consumption expenditures (per cent of GDP)

Source: World Development Indicators CD-ROM 2001. Own calculations.