

## **DEAD AID**

**Why aid is not working and how there is a better way for Africa**

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**2009 book summary**

This is a very interesting book which dispels many myths about Africa. It appears that Africa and the MENA (Middle East & North Africa) CHIMEA (China, India, Middle East & Africa) regions are at a turning point in the world's economy. China & India are already well underway while other players are still in the starting blocks.

### **This book is about aid-free development:**

- The most aid-dependant countries in Africa have not benefited by the aid provided. The 1\$ US trillion in development assistance over the last several decades has not made Africa better off.
- When aid was at its peak – 1970 – 98, the poverty rate in Africa rose from 11% to 66%
- A continent rich in natural resources is also plagued with corruption and conflict
- Aid money is easier to steal than the natural resources in the country
- Africa needs economic growth before reaching for free elections
- Africa should instead follow the China/Asia model:
  1. Attract foreign direct investment
  2. Develop a growing export market
  3. Don't rely on aid
- Continental Africa is home to over 50 nations

- The challenge of many African countries:
  1. Disease, poverty
  2. Corruption & political instability
  3. Poor infrastructure & erratic economic performance
  4. Outflow of capital by corrupt leaders
  5. Violent unrest & civil wars
- Africa is showing signs of economic revival over the past five years
- Many African economies have posted annual growth rates of 5% - Why?
  1. A surge in commodity prices – oil, copper, gold & foodstuffs
  2. Macro economic fundamentals are improving
  3. Social indicators are improving such as health
  4. Political stability – of the 48 Sub-Saharan African countries, over 50% hold regular democratic elections that can be deemed free & fair
- 30 years ago Malawi, Burundi & Burkina faso were ahead of China on an income per capita basis
- The Johannesburg Stock exchange was established in 1887. It is the oldest stock exchange in Sub-Saharan Africa
- Buldwayo stock exchange was established in 1896 & Windhoek in 1910
- In 2009, 16 African countries boasted functioning & transparent stock markets
- Average Sub-Saharan Africa per capita income is US \$1 a day. This is the poorest region in the world but it is starting to improve
- Life expectancy is 50 years. In Swaziland, it is 30 years
- Since 1996, eleven countries have been embroiled in civil wars
- The author argues that Africa is largely dysfunctional because of aid
- **Three types of aid:**
  1. Humanitarian or emergency aid
  2. Charity based aid
  3. Systematic aid – Government to Government, via institutions such as the World Bank
- **The history of aid** – The Marshall Plan was an aid program that helped Europe recover from the devastation of WW11. The program lasted from 1948 - 1952
- At the end of the 1950, after Europe was getting back on its feet, attention turned to Africa. If it worked for Europe, why not Africa?
- African countries were gaining their independence.

- Aid became the new geopolitical tool to fight the cold war. The weapon of choice in foreign lands for the USA/USSR was aid.
- One of the features of the cold war was the west's ability and eagerness to support, bankroll and prop up a swathe of pathological and downright dangerous dictators.
- 1982 – Africa, South America and other aid dependant countries were faced with rising interest rates on their debt. The crisis was fuelled by previous low interest rates, lax lending practices and high levels of debt.
- August 1982 – 12 countries led by Mexico defaulted on their obligations creating a debt crisis that if left unchecked would undermine the global financial stability. (Sound familiar?)
- Emerging countries were now faced with a perfect storm:
  1. Falling commodity prices
  2. Lower demand for their goods
  3. High interest rates
  4. Enormous debt
- More than US\$2 trillion of foreign aid has been transferred from rich countries to poor countries since 1960 – Africa is by far the biggest recipient. Aid has failed to deliver the promise of sustainable economic growth and poverty reduction.
- 1885 Berlin Conference – 14 nations produced a map of Africa littered with small nations that would always make it difficult for them to stand on their own two feet – economically and politically
- There are roughly 1,000 tribes across Sub-Saharan Africa, most with their own distinct language and customs
- Ethnic differences are a poor excuse for poor economic growth as many African countries have proven
- Africa has become so dependent on aid that there is no incentive for long-term financial planning, **no reason to seek alternatives to fund development**
- Consider this:
  1. In the past 40 years a dozen developing countries have grown by almost 10% of GDP per year and have reduced poverty.
  2. Yet over the same period, as many as 30 other developing countries, mainly aid-dependent in sub-Sahara Africa have regressed or failed to generate consistent economic growth.
- African countries that were coastal and resource-scarce, perform significantly better than resource-rich counterparts whether

- landlocked or coastal - landlocked, resource-scarce economies were the worst performers. This pattern exists globally as well.
- Donors have tended to tie aid in 3 ways:
    1. The aid recipient must spend it on specific goods and services from the donor countries. This extends to their staff as well.
    2. The donor can select the sector or project their aid will support.
    3. The recipient agrees to economic and political policies.
  - In practice, these conditionality's failed miserably and the donor continues to provide aid.
  - Democratic rule vs. dictator's – In a perfect world, what poor countries need is a benevolent dictator to push through economic reforms – a democracy creates too much in fighting.
  - The higher the per capita income in a country, the greater the chances of having a successful democracy.
  - Corruption retards growth. Fewer entrepreneurs (domestic or foreign) will risk money in a business venture where corrupt officials can lay claim to its proceeds. Investment stagnates, and falling investments kill off growth.
  - Google CPI (Corruption Perceptions Index) – ranks over 100 countries from 0-10. A low number = more corruption.
  - If donors are aware that aid does not work, **why do they continue to provide aid?**
    1. There is pressure to lend
    2. The World Bank employs 25,000 employees, the IMF employs 2,500, UN Agencies employ 5,000, Registered NGO's employ 25,000, private charities and government aid agencies employ 500,000.
    3. All these organizations provide loans and grants. Their livelihood depends on aid.
    4. Donors are subject to fiscal year concerns. Give it away before year end or risk losing it the next year.
    5. Donors fear that if they do not provide aid, the poor countries may not be able to afford to pay back the loans. The aid merry-go-round continues
  - Donor countries set conditions for the use of the money. However, these rules are rarely enforced.
  - In most functioning and healthy economies, the middle class pays taxes in relation to its government accountability. Foreign aid short

- circuits this link, because the government dependence on its citizens has been reduced, it owes its people nothing.
- Aid and civil war:
    1. Africa is the most conflict ridden region in the world.
    2. It is the only region where conflict is on the rise.
    3. Most conflicts are about control of resources
    4. A poor country that receives substantial aid is vulnerable to coups and takeovers.
    5. Aid increases the risk of conflict. To the victor go the spoils.
    6. Aid fosters a military culture
  
  - Aid can be inflationary:
    1. Higher inflation leads to higher interest rates
    2. Higher rates means that fewer businesses can borrow
    3. Fewer loans – less growth
    4. Less growth – fewer jobs
    5. Fewer jobs = more poverty
    6. More poverty = more aid
  
  - Aid engenders laziness on the part of the African policy makers. Aid is looked at as a source of permanent income. No incentives to look for a better way.
  
  - **WHAT IS THIS BOOK ABOUT?**
    1. Financing the development agenda so that economic prosperity might be realized.
    2. The choice of development finance is at least as important as the policies a government adopts.
    3. You can have the best development policies in the world, but without the right financial tools to implement it, the agenda is rendered impotent.
    4. A financing strategy is needed based on free-market tools
    5. The first 73 pages of this book are about the aid problem
    6. The last 80 pages are based on the solution.
  
  - **THE SOLUTION:**
    1. Government need cash regardless of political leanings.
    2. This is even more critical in poor countries or regions

3. Financial assistance should not be an infinite time line, it should be finite e.g. five years only
4. In the early stages of development, the private sector is not large enough to assume a large development rate
5. Over the past 20 years, donor aid is declining. Why?
  - Donors are growing weary
  - The Iraq & Afghan war draining financial resources
  - Weakened western economies due to the 2008/09 stock market crash
  - Changing demographics

Aid, like other addictions is not easy to wean off. This goal cannot be easily achieved without the cooperation of the donors. In the end, someone has to have the courage to say no to aid and yes to self – development.

### **THE PLAN:**

1. An alternative predicated on transparency
2. A gradual reduction of aid over a 5 – 10 period
3. Gain access to the bond market – How?
  - Acquire a rating. A rating measures risk
  - The rating determines the cost of borrowing
  - The country must sell the potential investors
  - Build a compelling case for its credibility and intention to repay
  - Investor interest in the emerging countries bond market is on the rise
  - The risk to the investor still exists.

### **TWO FINANCING STRATEGIES:**

1. The donor strategy:
  - Below market rate interest
  - Amortization up to 50 years
  - Lenient terms in the case of default
2. The bond market:
  - A history in Africa dating back to the 1820's
  - Market rate interest rates
  - Amortization rarely more than 30 years
  - Default terms more punitive

- In the 1970's & 80's, 35 African economies have had access to the bond markets

### **WHAT'S IN IT FOR THE INVESTORS?**

- The next best opportunity
- Countries that are worthy will attract more capital
- More credibility – more capital
- Higher ROI to the investor. The target rates for the fund managers is 10% net.
- An opportunity to spread their investment over several countries
- Emerging market bonds tend to fair well against the same stock market economies
- Emerging markets with oil benefit by high energy prices
- Google – JP Morgan emerging market bond index
- The hard currency emerging market government debt is approximately US \$100 Billion
- And as much as US \$3 trillion market trades per day
- What is good for the country is good for the corporation. A Corporation in Africa cannot have a higher credit rating than its country.

Aid vs. Bonds – The average cost of a World Bank loan is around .75% Currently Africa attracts less than 1% of global capital flows, down from 5% ten years ago.

Why FDI (Foreign Direct Investment) does not flow to Africa? Africa should be a natural; lower labour costs and the investable opportunity is high.

### **THE OBSTACLES FOR GROWTH:**

- Poor infrastructure, roads, telecom, power supply is scant
- When you factor in transportation, it increases the cost of production of goods and services. Therefore, it is cheaper to manufacture almost anything in Asia and ship it to Europe
- Corruption
- Bureaucratic red tape
- Poor legal environment
- Doing business in Africa is a nightmare
- A government could, like a click of a switch, change the system and make it easier for business to operate

- Many regions in the world thrive and grow economically because they care more

### **HOW TO ATTRACT FDI:**

- Recognize that FDI is an engine for economic growth
- Satisfied FDI investors would refer the country to other forms of capital. Bank lending, venture capital
- Give its legal and regulatory systems teeth. Investors need to feel confident that they have somewhere to go if their contracts falter
- Countries need to woo investors with incentives
- Promote the fact that investing in Africa has been more profitable than other regions. (UNCTAD)
- China is a major FDI player economically and educating Africans
- Africa is attracted to Chinese FDI because of the hassle free no questions-asked approach
- China is out hustling the west with its approach
- China needs oil and Africa has it
- Other major players in Africa are India, Russia, Japan, Turkey and the Middle East.
- December 2005 – China pledged US \$ 100 Billion a year within five years. The world markets view this as growth with steroids
- Economic theory states that trade contributes to growth at least two ways:
  1. By exactly increasing the amount of actual goods and services the country sells abroad
  2. And by driving up the productivity of the workforce

Countries that embrace trade fall into three categories:

1. Winning globalizers – increased growth and trade
2. Non-globalizers –who eschew trade but see little accompanying growth
3. Losing globalizers – increased trade and no associated growth. Many African countries fall into this group. Why?
  - Politics
  - Trading nations need assurance of supply. Food, oil, trade barriers from the west

Subsidies have a dual impact:

1. Selling produce to a captive home market at above world market prices
2. Dump the excess production at lower prices overseas this undercutting the struggling African farmer

Consider two of Africa export markets. Cotton & Sugar.

- Massive western subsidies cut out the African farmer to world markets.
- The west is the problem and the solution by imposing tariffs and subsidies
- Africa is also the problem imposing Tariffs to other African countries as a result trade between African countries accounts for only 10% of exports.
- By contrast, 40% of north America trade is with other north American countries and 63% of trade in western Europe between western European countries
- Africa's share of global trade is 1% - fallen from 3% 60 years ago

The solution to African prosperity is trade not aid

- In the new world, Africa does not have the technological equipment and know how to compete on many products where it once had a comparative advantage - A serious barrier to trade (also environmental & labour issues)
- It appears that in this new game, China is a more willing player to provide opportunity.
- China/Africa have simple wants and need products that satisfy both parties
- Google – China-Africa joint Chamber of Commerce & Industry
- Africa may have low labour costs but if you factor infrastructure costs, it fails in a price war
- Google – Area – Accurate Peters Projection Map (shows a countries proximity to the industrial hubs of Europe and the Americas)
- Trade with China could back fire with China's low wage and better infrastructure. China could flood Africa with cheap exports

- Africa should think like:
  1. NAFTA
  2. The EU
  3. ASEAN (Association of South East Asian Nations)

#### Micro-lending programmes in action (Grameen Bank)

- Small rural communities that are interdependent and trust each other
- This is the only ‘collateral’ they have
- A five person trading group is lent \$100 for one year
- At the end of one year, trading group A must repay the loan in full plus 8% - 10%
- The \$100 is then passed on to trader B
- If trader A does not repay, the group receives no more loans
- There is no group liability
- The group is implicitly liable in the sense that the behaviour of one individual affects the group as a whole
- If an individual does default, the group usually steps in and collects from the defaulter another day
- This keeps the loan cycle turning
- There are no legal agreements between the Grameen Bank and the borrowers
- In 1997, the Grameen Bank had 2.3 million members and a loan portfolio of US \$ 230 million with a default rate of 2%
- Borrowers have an incentive to match themselves up with other likeminded borrowers who are low risk

#### The KIVA model – California based interface:

- Anyone with a computer can take part in micro loans
- Since 2005, US \$30 million has been lent, 4500 loans in 42 countries – low default rates

#### **MAKING DEVELOPMENT HAPPEN:**

- What if the aid agencies, one by one called their clients and said that in five years – no more aid!
- There would always be exceptions

Would there be more:

- War – not likely, the war lords would have no easy aid money to steal and buy arms from developed countries
- Famine – The poor don't get the money now

**Observations and opinions from Wayne Taylor:**

1. I do not agree with all of Ms. Moyo's writings. However, they deserve consideration
2. I believe that since she spent some time at Goldman Sachs and the World Bank, there is a bit of self serving with her solutions
3. As a Chamber of Commerce volunteer since 1978, I believe that rural Alberta can learn from this book. As I was reading the book, I often thought about the political, economic and social challenges that small towns face which can be compared with some of Africa's challenges
4. I now take a totally different point of view about using our Canadian tax dollars to financial support third world countries. The next time you meet with your MP, please pass on this book summary to him/her. I will be sending a copy to the international trade minister.
5. We should all do our best to be self sufficient and not rely on municipal, provincial or federal aid whenever possible.

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