HOUSE OF LORDS

SELECT COMMITTEE ON ECONOMIC AFFAIRS

The Economic Impact and Effectiveness of Development Aid

Oral and Written Evidence

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1. Overview

Adam Smith International provides technical assistance, some of which is financed by DFID and some financed by other donors, including the World Bank, Asian Development Bank, Inter-American Development Bank, the European Union, the Swedish International Development Agency, Danida, CIDA, AUSAID, EBRD etc.. We also provide advice and assistance to a wide range of governments who pay directly for our services. We have conducted evaluations of aid programmes financed by a variety of donors. We are thus familiar with a number of aid donors and aid modalities[1].

Below we comment on the effectiveness of some of the key aid modalities:

2. Supply of aid through multilateral institutions

Much UK aid is supplied through multilateral institutions. It is our contention that such aid is generally much less accountable and usually much less capable of being evaluated effectively. Below we set out some thoughts on two of the multilateral organisations to which DFID contributes funds.

2.1 The World Bank

The World Bank employs a lot of good quality personnel, often at the cutting edge of thinking in their various fields. However, these staff are spread too thinly across the various programmes and projects that they have to manage. This means that they cannot keep an effective grip on the programmes and projects in question.

The World Bank is good at providing an intellectual lead but often very poor at following through. Its country assessments frequently provide an excellent guide for action on the part of all donors, but the World Bank is not itself well-placed to implement the programmes it has identified as necessary.

A central flaw is the World Bank approach of turning over funds to developing country governments to procure and administer assistance. Developing country governments in general do not have the capacity to do this effectively and the administrative arrangements for the procurement and administration of projects are often extremely poor. Moreover the complex World Bank procedures that are imposed create extra delay and inefficiency.

Thus this practice of World Bank funds being transferred to the direct control of developing country governments compounds the problem of the lack of control and influence of the small number of World Bank staff who are stretched in dealing with too many programmes. This is exacerbated by the institutional prejudice in favour of 'getting money out the door.' Spending more money is seen as a measure of success. A focus on quality above quantity would be preferable.

[1] Adam Smith International is a separate organisation from the Adam Smith Institute.

Relying on procurement mechanisms and decision-making procedures of developing country governments to disburse funds is a mistake. In most cases the governments concerned do not have the trained and capable mid-level procurement staff able to conduct what are often quite complex procurements. This is usually as a consequence of the weak civil services in those countries, which tend to employ very many people at lower levels so funds are not available to recruit and retain sufficient effective officials at mid and higher levels.

Thus in most developing countries the level of talent in public bodies is thin and concentrated at the top. Top officials are unwilling or unable to delegate authority to middle-ranking or junior officials. Thus a key consequence of handing procurement and administration tasks to developing country governments is to divert precious senior management time away from critical policy and management tasks.

It is notable that senior officials in developing countries are closely involved in the minor bureaucratic detail of TA procurement and administration of funds. For example, if one's invoice isn't paid one usually has to intervene with the Permanent Secretary or Director-General. The equivalent system if applied to DFID would involve contractors contacting the Permanent Secretary of DFID to ask why their invoices hadn't been paid and then working with his office to locate the paperwork so he could sign it and pass it to someone else for payment.

This results not only in waste of developing country senior management time, but in a more general reduction in resources spent on development as opposed to administration. For example the costs for a firm like ours of complying with poorly run procurement processes are considerable. Even worse are the time costs of dealing with the administration of projects which have weak clients. A significant proportion of time can be spent on chasing payment of invoices and preparing, submitting and chasing superfluous paperwork. Given that budgets stay the same, if we spend 25% of the project budget on administration rather than 5%, then that is 20% less resources being spent on development.

In some countries the World Bank hires in firms or individuals to manage procurement on behalf of the host country government. This rarely involves any improvement in efficiency. For example in Afghanistan procurement is often done by Indian firms who are, in Afghanistan, known mainly for their inefficiency. Too much emphasis is put upon price in the procurement process and quality is then lost. Contract administration is also very poor. Extensive bureaucratic processes are required in advance of payment (e.g. copies of passport entry and exit stamps for all advisers even when they were already situated in country; original copies of receipts provided for every invoice etc.) and invoices are paid extremely late and only after repeated interventions. Large resources have to be diverted into contract administration to deal with these problems.

Moreover, giving control of funds directly to developing country governments significantly reduces the independence of advisers retained on technical assistance assignments. By contrast, advisers under DFID contracts enjoy a certain amount of independence. They feel that they are more able to raise their hands when they see misconduct or inappropriate decisions than they would if they were directly contracted by the Government. When a Ministry directly controls the budgets it is difficult to address sensitive problems, such as inappropriate decisions by senior counterparts. Under a DFID-financed project one can say "DFID would refuse to authorise that" and bring in the DFID project officer if necessary. When the counterparts directly control the budget any similar approach to the World Bank is likely to result in even greater difficulties in getting one's invoices paid. We have direct experience of this.

Another difficulty arises from circumstances where the World Bank gives substantive programme funds to a developing country and then asks them to design the individual interventions. Where projects are designed largely by people in beneficiary country governments with little international experience of the reforms involved and of designing such projects it is not surprising that the results are often poor. For example, the common practice of splitting a programme budget into lots of very small projects, which is very harmful to effectiveness, generally derives from design by people with insufficient experience. These very small projects often involve singleton consultants that are poorly co-ordinated and who often fail to achieve the results of a properly managed and co-ordinated programme. Money also tends to be spent on equipment of dubious necessity, which explains the vast quantity of 4x4 vehicles usually found in Ministry car parks.

For the reasons quoted above and also the complexity of World Bank procedures, World Bank spending is invariably delayed, sometimes for years. Delays make it more difficult to plan quality projects, as no-one knows when the resources will be available. In many cases assistance needs to be delivered quickly in order for it to be effective. Most importantly, the positive effects of the intervention are delayed, with a knock-on effect on the country concerned. When the World Bank commits to funding a programme it is usually impossible to tell when it will actually be delivered.

Often the World Bank is chosen to run a multi-donor trust fund. These are often very slow and inefficient. Because of their multiple parentage there tends to be a lack of accountability. For example the Financial Times reported in 2010 that after more than four years of $524m committed to the South Sudan Multi-Donor Trust Fund (MDTF) $323m was unspent. The Overseas Development Institute (ODI) commented on the Sudan MDTFs that:

> "these World Bank-administered funds were supposed to ensure coordinated external donor support through to 2011. In practice, they have failed to achieve visible impact (Scanteam, 2007). The rate of disbursement has been excruciatingly slow, with most projects failing to deliver 'tangible goods' to the public even by year two (Fenton 2008). Bureaucratic World Bank procedures, staffing problems and protracted negotiations on who does what hindered initial implementation (Pantuliano et al., 2007). The government's inability to cope with the bureaucratic requirements caused serious delays and inefficiencies."[2]

2.2 The United Nations Development Programme (UNDP)

Much work performed by UNDP is of an extremely poor quality. Critically while UNDP likes to present itself as a donor it is more often than not an implementer of projects and programmes financed by other donors. A typical modus operandi of UNDP is to go to a developing country government and sell them on a particular concept for a project. UNDP then goes to the likes of DFID and other donors with money and says "the Government of X has asked us to carry out this project. Will you co-finance it with us?" Once the funds have been contributed, UNDP proceeds to implement the project.

[2] International Engagement in Fragile States: Lessons from Southern Sudan, ODI, November 2009.

We conducted a recent evaluation of technical assistance provided by UNDP in Somalia[3] and found that not only was it poor it was next to impossible to establish whether anything was being achieved. Our report concluded:

> "UNDP Somalia is obliged by UNDP headquarters to use a web-based management information system called ATLAS. UNDP kindly gave us a demonstration of the system. Quite apart from its complexity it seems to take several minutes to load each page. From our brief review we noted that much data was missing from it – presumably because staff find the system too burdensome to use. It is clear that this system is so complicated and difficult to use that it is not a viable monitoring or management tool. We put this point to UNDP Somalia senior management who agreed with us."
>
> "The weakness of M&E (systems and operation) has been a fundamental flaw. Quite simply one does not know whether activities and outputs are effective, lasting and of good quality, and how much progress is being made relative to intended outcomes.[4]"

Other evaluations of UNDP TA have come to similar negative conclusions.[5] The evaluation of UNDP's work in Afghanistan commissioned by UNDP itself and entitled "Assessment of Development Results in Afghanistan"[6] stated that:

> "Monitoring and evaluation of UNDP programmes for the period 2002 to 2008 was limited by the following:
>
> - Constant redefinition and repackaging of expected outcomes in keeping with changing requirements under corporate outcome indicators contained in documents such as the Multi-year Funding Framework and the Corporate Strategy
> - Failure to develop clear criteria and indicators for monitoring the achievement of programme outcomes on a regular basis
> - Failure to establish a baseline and to collect data to monitor results at the outcome level (activities and outputs are faithfully monitored and reported on)
> - Duration of the country programme and projects, which is too short for the attainment of results at the level of outcomes.
> - Tendency to state expected outcomes in broad and sometimes grandiose terms that tend to render them less useful
> - Absence of a facility independent of project funding that is able to monitor performance beyond the limited duration of projects and at the level of outcomes and impact.

3 Evaluation of UNDP Strategic Partnership for Somalia, Adam Smith International, June 11, 2009
4 Evaluation of UNDP Strategic Partnership for Somalia, Adam Smith International, June 11, 2009
5 For example, see Sida Evaluation 2008:49 Sida's Support to UNDP in Sierra Leone; Sida Evaluation 2008:50, Assessment of Sida Support Through UNDP to Liberia Recovery and Rehabilitation; Report of Investigation into UNDP by USDAID Inspector General, regarding USAID Agreement No. 306-A-00-03-00509-00; Afghanistan: assessment of development results: evaluation of UNDP contribution, UNDP evaluation office May 2009.
6 Assessment of Development Results: Islamic Republic of Afghanistan, UNDP 2009

> Because of the rigidity of ATLAS, it has also become difficult to obtain definitive, reliable and timely figures on expenditures. This is disturbing for an organization that predicates its existence on the efficient management of funds.
>
> Monitoring remains heavily output and activity based, and these are meticulously recorded. Outcome-oriented, results-based monitoring and evaluation systems are not yet in place, and no baseline data has been collected to establish the basis for such monitoring."

UNDP projects are difficult to monitor not only because there is inadequate data but also because they can hide behind UN immunities when it comes to investigations. For example the USAID Inspector General identified gross mismanagement of a UNDP $25.6m USAID-funded quick impact project[7]. The UNDP misspent millions of dollars and delivered shoddy work, including a bridge at risk of collapsing. $7m was withdrawn by UNDP after project closure and diverted to other countries. Despite a court order the UNDP refused to answer questions, citing UN immunities.

DFID has recently conducted a multi-lateral aid review in order to help determine which institutions were performing well and which performing badly. It is surprising that it concluded that UNDP's performance was 'good.'

The reasons why UNDP-implemented TA is ineffective are not hard to find. It involves funds being given on a non-competitive basis to a relatively unaccountable international bureaucracy which has created lots of complicated internal rules to govern its operations and provides few incentives for success.

We strongly recommend that if it is to receive any further UK funds UNDP should be forced to compete with other providers for implementation assignments.

3. Bilateral aid, spent directly by DFID

3.1 Budget support

DFID has in the past provided significant sums directly to governments as direct support to their budgets, although this form of aid is on the decline under the current Government.

DFID's definition of budget support is as follows: "Poverty Reduction Budget Support (PRBS) can take the form of a general contribution to the overall budget (General Budget Support) or can be earmarked to a discrete sector or sectors (SBS). In both cases the aid is spent using the government's own financial management and procurement systems and is accounted for using the government's own accountability systems".

The problem here is that those governments' accountability systems are so weak that one really doesn't know what happens to the money. Of all the countries to which DFID provides budget support, only one, India, can be said to have a genuinely independent and effective audit office. The others do not, by any stretch of the imagination. And in the case of India the independent audit institution is frequently ignored and even the Prime Minister has confirmed that corruption is pervasive. PM Manmohan Singh recently said "Pervasive

[7] Report of Investigation into UNDP by USAID Inspector General, regarding USAID Agreement No. 306-A-00-03-00509-00

corruption in our country tarnishes our image. It also discourages investors. The big fish often escape punishment. The poor are disproportionately hurt.[8]"

Of course it is not only a strong, effective and independent audit function that is required to ensure that funds are spent properly and effectively. We would suggest that the following should also be preconditions for the supply of budget support:

- A strong, effective and independent statistics function – to provide accurate data on state expenditure
- Strong public financial management systems
- A free media, so corruption and other abuses can be investigated and publicised
- Effective independent judicial and anti-corruption institutions
- A strong, transparent budget system that is open to public scrutiny
- Effective parliamentary oversight of the budget process and public spending, with parliamentarians able to analyse budget proposals, monitor expenditures and evaluate outcomes
- Effective civil society oversight of the budget process and spending
- Clear evidence that Ministers, MPs and the rest of the country's elite are paying their fair share of taxes
- Absence of excessive military spending and lavish or wasteful spending on the elite or unnecessary prestige projects
- Absence of corruption – so funds are not siphoned off for personal or political gain
- Effective delivery of public services and means of qualitative analysis of such services
- High standards on human rights – so we are not funding an abusive regime

Countries in receipt of UK budget support lack most of these attributes, in some cases all. Tanzania provides a pretty typical picture of a country in receipt of UK budget support:

- The Auditor-General estimated that 20% of the Government budget is lost due to corruption
- A World Bank survey identified major leakage from a Primary Education Development Programme, but the Government orchestrated a cover-up
- Massive corruption was revealed in natural resource aid programmes
- Very poor budget transparency – minimal information is provided to the public
- The Supreme Audit body is not independent and not able to fulfil its assigned tasks due to lack of finances, infrastructure and human capacity
- There is excessive expenditure on a large & inefficient civil service

If we take Pakistan as another example, the picture is similar:

- Endemic corruption: The 2009 Transparency International corruption perceptions report says corruption has grown 400% in the last 4 years. A 2009 World Bank report states corruption is 'a serious and growing obstacle to the investment climate'

[8] Indian Express on Prime Minister Manmohan Singh's speech of August 26 2009

- The anti-corruption National Accountability Bureau has been neutered. It estimates that over US$1.8 billion has been lost due to immunities granted to politicians and bureaucrats and the restrictions placed on the anti-corruption body
- The subordinate judiciary is seen as notoriously inefficient and corrupt. It lacks independence and contributes to a general culture of impunity
- The Auditor's Department is not independent and is frequently accused of collusion with those it audits
- The Public Accounts Committee is ineffective and largely ignored

Given this general picture the coalition government is reducing the amount of funds allocated to budget support. This seems wise.

3.3 Technical assistance procured and supervised directly by DFID

Our view is that technical assistance (TA), when provided effectively, can have a hugely positive effect. It is a form of aid that can have a major impact out of all proportion to its cost and help achieve transformational change. As examples we cite below demonstrate, the return on investment in well-designed and well-delivered TA can be very high indeed. In respect of DFID directly procured TA it is notable that:

- DFID has a well developed system for managing and monitoring performance, securing vfm and evaluating impact of TA;
- DFID TA is contracted after a rigorous, merit-based process of public procurement;

TA has increasing relevance in that it is often used in higher volumes in conflict affected countries both as a means of building and strengthening institutions, supplementing weak capacity, providing civilian stabilisation and reconstruction support and providing advisory services directly to counterparts in government.

Where technical assistance can either help achieve major economic change or help a government raise more of its own revenue it can be particularly effective. We think it is most useful to describe a number of cases of DFID-financed technical assistance that we have provided or are providing:

The Strengthening National Provincial Tax Administration in **Afghanistan** project, now in its second phase, originally started in 2004. It is credited with playing a major role in reforming Afghanistan's tax administration system and providing a reliable and expanding source of revenue for the Afghan Government.

Key achievements include:

- Major increases in revenue collection, with all IMF targets being exceeded. E.g. revenue for the first six months of 2009 increased by 60% compared with same period in the previous year. Income tax collection rose from US$13.7 million in 2003 to US$267.9 in 2008 – a twenty-fold increase. The overall revenue target for 2010/11 was $1.59bn for 2010/11. Figures issued on April 25, 2011 show that this target has again been exceeded, with $1.87bn having been raised.

- A new tax policy has been put in place, modern tax laws and regulations passed, tax administration staff recruited and trained, and Taxpayer Offices established.

- These reforms, while being consolidated in Kabul, are also being rolled out to priority provinces in key economic centres around Afghanistan.

In the context of revenue collection, an important point to bear in mind is revenue collection as a proportion of GDP; the revenue collection figures mentioned above have outstripped economic growth considerably during the period of the project, with revenue as a proportion of GDP rising from less than 7% to more than 11% in the space of three years. Along with the high nominal revenue growth figure, this is an extremely strong indication of the very successful impact the project has had. By helping the Afghan Government increase substantially the revenue it raises the project is contributing considerably to both creating a viable Afghan state and the conditions in which the international community can greatly reduce its involvement.

Success in increasing revenues is also being achieved in Burundi, where we are working to help the establishment of a unified revenue authority in Burundi. Since September 2009, ASI has been the principal provider of technical assistance for the establishment and development of the Office Burundais des Recettes (OBR) under DFID's Regional East African Integration Programme (2008-2013). OBR is led by a high performing Commissioner General (CG), Kieran Holmes, who was recruited and appointed by DFID and TradeMark East Africa (TMEA). ASI continues to support OBR under the funding of TMEA and currently has advisers in place who provide support on various aspects of tax and customs reform. ASI has supported the CG and his team to deliver an impressive array of achievements so far, which include:

- The recruitment of 414 new members of staff to fill senior and middle management roles in OBR, through what was Burundi's first open and transparent recruitment process. The knock on effect on public perception about OBR has been tremendous. The CG is also leading the implementation of a comprehensive organisational development plan and a five year strategic plan.

- A 33% increase in revenue collected from July 2010 – April 2011 over revenue collected in the previous year. The increase in revenue collection between January-April 2011 has been 43.5% over the same period in the previous year. There is a growing appreciation at the highest levels – namely the President and the two Vice Presidents – of the utility of high tax to GDP ratio in reducing dependence on external aid. The amounts of money involved are significant for a small country such as Burundi. OBR is on course to bring in an additional BIF 100 billion+ over and above the Treasury Plan in 2011. That would work out at about an additional USD $80 - $100 million.

- The establishment of a code of conduct for OBR and the dismissal of numerous staff for corruption.

- Introduction of modern tax collection methods such as self-assessment and greater computerisation in tax and customs, in addition to the creation of open plan offices to improve transparency, and transfer of special accounts held by Ministries to OBR.

- Improvement of border controls, including plans to establish one stop border posts, VSAT facilities at borders and development of specialist skills to reduce smuggling of goods.

That OBR means business about collecting taxes and reducing corruption has been the strongest message coming out of this reform process. There is considerable resistance to change within OBR and in some sections of Burundian society. OBR officials are frequently harassed and the CG is currently protected by 17 Presidential Guards. However, the constituency of supporters for revenue reforms has grown as the government realises the fiscal independence it is gradually acquiring through improved revenue generation.

Our work to strengthen infrastructure in Nigeria through our Nigeria Infrastructure Advisory Facility (NIAF) is an example of the ability of technical assistance to achieve transformational economic change. One important success has been the creation of a policy and institutional framework for PPP. Mansur Ahmed, Director General of the Infrastructure Concession Regulatory Commission said "without NIAF's pragmatic, flexible and high quality assistance Nigeria would not be nearly so advanced in its PPP programme". As a result of NIAF assistance the Federal PPP Unit will be able to attract an estimated $5bn of additional private sector investment in the infrastructure sector; the Lagos State PPP Unit will be able to attract an estimated additional $3bn over the next 5 yrs.

However, the main project focus is now on electricity sector reform. Absence of adequate power supplies is probably the most significant barrier to economic growth in Nigeria. Our recommendations of how to tackle the problems have been accepted by the Nigerian government and power sector reform is now the Nigerian President's highest priority. The potential gains are huge. The Nigerian Government estimates the cost of unserved energy to be (in terms of lost GDP) 20 trillion Naira per year (circa USD$ 130bn). This should be contrasted with DFID's total 2009-10 budget of $9.9bn. The impact in terms of poverty reduction even if our project is only partially successful will be immense. Interim results have already been significant. For example, we have already achieved massive improvements to the steady and reliable generation and supply of power. Between May 2009 and April 2011 **NIAF has helped the Nigerian Government increase power generation by over 85%.** Now, for the first time in over a decade, Nigeria is generating over 3800MW of power.

In **Sierra Leone** ASI has helped transform the legislative and institutional framework for the minerals sector. The project completion report, written by independent evaluators, stated:

> "ASI has carried out an exemplary project in terms of their management, technical competence, engagement, and commitment. GoSL has high regard for the quality of the work done. The outputs of the project are clearly evident in the publication (following full civil service scrutiny through the Attorney General's Office, and often engagement of Parliamentary draftsmen) of two new Acts, Bills, Regulations and Guidelines totaling more than 500 pages of official text.
> Some components of the work, including revisions to the Mines and Minerals Act and work on the critical area of regulation and support for Artisanal and Small Scale Miners should be disseminated as examples of good practice internationally."[9]

[9] Sierra Leone mining Project Completion Report, January 2010

The mining sector has the capacity to serve as the engine of economic growth if effective and efficient Government regulation of the sector is introduced. A conservative assumption is for extra GDP growth of 1.2% per year if supported by a growing mining sector. This means that by 2020 some 900,000 people could be lifted out of poverty due to mining industry growth. The increases in Govt revenue from the mining sector could fund within 3 years a doubling of the Govt direct financing component of the Development Budget or the employment of an additional 30,000 health care professionals.

4 Conclusion

Aid can be effective and achieve a significant economic impact but it very much depends on the modality chosen and the effectiveness with which it is implemented. Unfortunately there are many inefficient bureaucracies in the world of aid.

We recommend that DFID should:

a) reduce the amount of money it passes to inefficient aid implementers, and expand the amount it contracts directly, thus getting better value from its own procurement and management staff
b) In particular cease providing funds on a non-competitive basis to inefficient UN bodies which implement projects directly
c) Focus more on providing transformational technical assistance, particularly that which helps countries improve revenue collection and increase economic growth

30 June 2011

Adam Smith International, Actis and Ashmore Investment Management Ltd—(QQ 252-283)

Evidence Session No. 8. *Heard in Public.* *Questions 252 - 283*

TUESDAY 25 OCTOBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Lord Hollick
Baroness Kingsmill
Lord Lawson of Blaby
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Witnesses: **Jonathan Pell**, Adam Smith International**, Simon Harford**, Actis, and **Jan Dehn**, Ashmore Investment Management Ltd.

Q252 The Chairman: Good afternoon, gentlemen. Thank you very much for coming and welcome to the Economic Affairs Committee inquiry into the impact and effectiveness of development aid. I just have to say for the record that copies are available of our Members' entries in the Register of Interests. We clearly recognise that all our witnesses, particularly some of you this afternoon, also have direct interests in this matter. That is inevitable in this sort of inquiry.

We have a photographer coming at about 4 pm to take some photographs for a House of Lords publication; I hope that you have no objection to that. Please do not be put off. It is the only hearing that we have photographs for, so you are in a privileged position.

I would be grateful if you would speak loud and clear for the webcast and the shorthand writer. Please do not feel that each of you has to answer every question. If you agree with what has already been said by the first respondent, then leave it at that. Do any of you want to make a statement, or shall we go straight into questions? Let us go straight into questions. I start by asking you something that in a sense enables you to make a statement. Will you describe briefly what your organisation does and what relationship, if any, you have with official development agencies?

Jan Dehn: I work for Ashmore Investment Management Ltd here in London. We are a FTSE 100 company specialising in investing in emerging markets. We manage just under $60 billion of funds mainly from institutional investors—Governments, pension funds and so on. We invest exclusively in emerging markets—in pretty much all the emerging markets where we find opportunities. We invest across all asset classes that are available within emerging markets. We have no formal relationships with development agencies, be it DfID or any others. But we participate quite actively in policy debates on an informal, and sometimes formal, level, often with the international financial institutions based in Washington but also with individual development institutions such as DfID.

Lord Lawson of Blaby: For clarification, you said that, inter alia, you act of behalf of Governments.

Jan Dehn: We have a very broad client base. Some of that client base is central banks. Central banks, as you know, have accumulated amounts of central bank reserves that get invested in various assets, including government bonds, currencies and so on. Some of these flows go into emerging markets as well.

Jonathan Pell: Good afternoon. I work for Adam Smith International. For those of you who do not know about us, we are an independent management consultancy company. We specialise in providing Governments, particularly those of developing countries, economic and government reform advice. I have been with the company for 10 years. I lead our portfolio of private sector development projects. To give you a flavour of what they are—those that are funded by DfID—we currently implement a large infrastructure development programme in Nigeria called NIAF, the Nigeria Infrastructure Advisory Facility. We also advise on extractive industries governance, particularly in relation to mining. So, at the moment in Sierra Leone, we are advisers to the Ministry of Mineral Resources on improving governance of the mining sector there. One more example is in Nepal, where we are working on an agriculture and development programme, looking at specific subsectors, developing strategies and then implementing them in the future. We work for a number of other development agencies. The Australian Government's equivalent of DfID is called AusAID. We are doing increasing amounts of work for them. We also do a lot of work for the World Bank, less so for some of the other donors like the European Commission or the Asian Development Bank.

Simon Harford: Good afternoon, I am with a company called Actis, which is also an investor in emerging markets—like my colleague, exclusively in emerging markets. We operate in China, the rest of Asia, all of Africa and parts of Latin America. Our model is a private equity-type model, so we invest our funds as a shareholder into medium to large-sized businesses. We hold those investments for many years, typically between four and six, as a very active shareholder helping those businesses to develop. Then, after X years, we sell the investments to return the funds to our investors. We have approximately 118 investors from whom we raise the funds and we then deploy those investments in the markets that I described. I am a partner of the firm. I am living and working in Africa. I am the co-head of our African business. In Africa itself we have about $1.5 billion of investment; in total we have about $4 billion of investment.

We have an indirect relationship with DfID, which is twofold, both aspects being through CDC. Our origins, as some of you will be aware, are that Actis was created out of CDC in a restructuring seven years ago. The Government, through DfID, still holds 40% of Actis, and the balance of 60% is owned by the partners of the firm. That is one relationship: as an owner, effectively. The second relationship is that CDC, in its post-restructuring guise, is also an investor in our funds. They are now one of, as I said, 118 investors that we have.

Q253 The Chairman: Thank you very much and, Mr Pell, thank you very much for the evidence paper that you gave to the Committee. I would like to ask one or two questions about it; I do not know whether the others have seen it or not. They have not. You produced some pretty devastating criticisms of the World Bank and the United Nations Development Programme. I wonder if you have any similar comments to make about European Commission aid, because you are really talking about the public agencies. What policy conclusions do you draw from the criticism that you have made.

Jonathan Pell: First off, on the European Commission, we do a small amount of work on EC-funded projects. One example is the justice sector reform programme in Afghanistan, which is just coming to an end. For us, as implementers of these projects, the EC is almost a different market from the one in which we normally operate. What I mean by that is that the commercial arrangements on an EC-funded project are different from those with DfID, or even the World Bank or some of the Scandinavian donors, for example. That means that the technical experts that we can bring into projects tend to be much cheaper. What we cannot do on an EC project is bring in very specialist technical expertise, which, with all respect to DfID, we are able to do. That leads us to conclude that EC projects tend to be less effective in general. There are some examples of EC projects working, but generally we are slightly concerned that our brand would be damaged if we started working for the EC as well, given that we would like to think that we operate at the top level of our industry and achieve results in our projects.

In relation to the second part of your question about the policy conclusions, it was interesting to see the report of the Select Committee, which drew on our paper as well as others who provided evidence. In terms of DfID, it was interesting that the theme that came through from that paper was that DfID has a comparative advantage in infrastructure, where it is advising on improving governance. We wholeheartedly agree with that conclusion. DfID is not best suited to financing physical infrastructure development; DfID is best suited to advising on improving the conditions for private sector investment in infrastructure.

The Chairman: Were you referring to the Public Accounts Committee report when you said "Select Committee", or was it something else?

Jonathan Pell: We contributed to the International Development Committee. Were you referring to another report?

The Chairman: There was a Public Accounts Committee report last week.

Jonathan Pell: We are quite active in this arena, so you will have to forgive me for confusing them.

Q254 Lord Lawson of Blaby: Just for clarification, it is an extremely helpful and well informed paper, and says some useful things. You divide, so far as I can see it, bilateral aid into budget support and technical assistance. Is there not a third element, which is supporting and financing a particular project such as, in education, getting schools up and running or something? Do you class all that as technical assistance?

Jonathan Pell: No, I would not. That is a correct observation; in terms of the modalities of development assistance, you are correct. One is technical assistance, which is what we specialise in. Another is budgetary support: giving money to a Government. That money filters through the public financial management channels of that Government.

Lord Lawson of Blaby: But there is this third thing, which is project support—not blanket budget support and not technical assistance. So, in a nutshell, what is your verdict on this third category, because you do not have it here?

Jonathan Pell: It is certainly a distinct category. Would you like me to comment on the effectiveness of that spending?

Lord Lawson of Blaby: Yes. You say that budget support is riddled with corruption, a lot of waste and all that kind of thing, whereas you say that technical assistance is rather better. Where on this spectrum does this third category sit?

Jonathan Pell: In my experience, it ranges. What DfID lacks—I think that this is being responded to now—is an effective measure of the impact of those kinds of projects. Attitudes in the past have been to finance these kinds of facilities, whatever they may be, and then not really to follow up with an accurate evaluation of whether that has been effective. You are likely to get a range of outcomes on that. Some will be more effective than others.

Q255 Lord Hollick: You criticise both the World Bank and the United Nations and, obviously, by implication, DfID for funding those bodies. Have any of these bodies taken issue with your arguments? How did they rebut them? What is their response?

Jonathan Pell: We asked the question ourselves: were we going to get some phone calls from the World Bank? Of course, we work for the World Bank as well. They are an important client of ours. We have not had a phone call yet. With the World Bank you get very smart people. Their permanent staff are among the best. Our view is that those skills do not translate to effective programmes. Again, some World Bank programmes would be effective, but particularly in the area of infrastructure, which we cited as an area of particular concern, you get mixed results.

Lord Hollick: And DfID?

Jonathan Pell: I would say, informally, that we have had very positive feedback.

Q256 Lord Lipsey: I want to take you back and ask you to define a bit more closely what you mean by technical assistance. The image that springs up is that of sending engineers out with blueprints as to how to build things. As emerges from your paper, it is actually something really quite different, much of it to do with advice to Government. Could you just define it a bit more closely for us?

Jonathan Pell: Absolutely. You are right that technical assistance can take on a variety of forms, and it can be provided by a range of people with different expertise. We specialise in providing technical experts, primarily to Governments. For example, in Nigeria, we advise the Government of Lagos on public/private partnerships. In that respect, technical assistance would be defined as the technical expert on PPPs advising the Government of Lagos on that issue. At the end of the day, technical assistance is consultants.

Q257 Lord Shipley: I heard you just say that you believe in giving technical support to Governments. Does that not actually encourage corruption or inefficiency? Is it not better to provide technical assistance to projects, managed more directly through organisations other than governmental ones?

Jonathan Pell: That is a very good point. For sure, in the work that we do, sustainability and an exit strategy are paramount. We, as development practitioners, realise that at the end of the day our time is transitory. We are there to provide technical assistance and to build capacity—to build the skills within the organisations within which we are working—so that we can leave and the work that we have developed will continue. Certainly, we have found that you can work through third-party organisations who are players in the market beyond the period of our intervention.

Q258 The Chairman: Could I follow up your paper on one particular point? On budget support, you say that the problem is that those Governments' accountability systems are so weak that one really does not know what happens to the money. You cite India as about the only country that you think actually fits your requirements. You then go on to list a whole series of things that you think are necessary as preconditions for the supply of budget support; I will not read them all out, but they are quite formidable. Can developing countries be expected to provide all of these to a significant level?

Jonathan Pell: I think that, with the right support, yes. We are certainly not proposing the end of budgetary support—absolutely not. But budgetary support would need to be coupled with support in public financial management, so that the systems and the capacities of those individuals managing them are established. In short, yes, I think that developing countries and the public servants working in those Governments can meet these levels of capacity.

The Chairman: But are you really arguing that only one country can do so at the present time?

Jonathan Pell: Yes. Right now that is the case, but I have seen in the projects that we manage that the situation is improving in some other countries.

Lord Lawson of Blaby: But if you were advising DfID, which no doubt you do, would you say, "Cut budget support and put the money into more technical assistance"? Would that be your advice?

Jonathan Pell: It varies between countries, but I think that the answer is yes, until systems are established that can manage that budgetary support effectively.

Q259 Lord Tugendhat: My question follows from, and overlaps with, what has been said. What do all of you see as the principal impediments to sustained economic growth in the poorest countries and the extent to which aid can play a part in removing them? In all the other evidence that we have received, there is a tendency for people to attach a totemic significance to the 0.7%, a totemic significance to the flow of money and altogether less emphasis on the sort of things that we have just been hearing about. Obviously money is important and economic aid is important. What would you regard as the principal impediments to sustained economic growth?

Simon Harford: I think that we all have views on that. I have not read the paper, but listening to Mr Pell's comments I can try to supplement them. First, I suggest from our experience that maximising the role of the private sector is by far the greatest engine for growth. There is a role for aid and government activity but, in all the emerging markets that we operate in, unlocking the full potential of the private sector is the ultimate goal. Therefore, I suggest, the answer to the question becomes, "What can aid do to help unlock the full potential of the private sector?" On that point, I concur very much with some of the themes that Mr Pell was exploring. My organisation and I personally, because I live in Africa, see it from the other end of the telescope. We are in the countries, not just in Africa but in all the emerging markets, trying to find ways to put investment capital into companies and help them grow. We encounter a whole load of challenges to doing so. If, somehow, the technical assistance point that Mr Pell talks about, which I fully support, can be targeted as best as possible against these obstacles that we and the rest of the private sector find, that would have an extremely powerful catalytic effect and would be a very powerful win-win between technical assistance and what the private sector can then get on and do.

If I may give some examples—Mr Pell has touched on some of these—there is often not so much of a shortage of capital for the bigger businesses, but there very much is for the smaller, entrepreneurial SME businesses. Those in particular perhaps should be supported with capital and technical assistance, because that is the sort of zone of the economy where it is so far, in the less developed countries, much harder to find capital. There is capital available from private sources for many of the bigger companies. So one area is SMEs.

The next area, in no particular order, would be the regulatory environment. The more that technical assistance can be directed to improve the regulatory environment—not just the rule of law, but the capital markets, the Securities and Exchange Commission or its equivalent and the infrastructure that goes around the private sector—the more you have a hugely beneficial impact. So, for example, in Nigeria, where I have lived for many years, I think a mixture of DfID and the Foreign Office has done some excellent work behind the scenes with the regulators to help them to advance their regulatory systems. That is very out of sight, but it is hugely valuable because private sector capital and firms like us can then operate and invest with more confidence.

There is the same story in anything to do with skills. Perhaps the biggest obstacle we find to our supporting growth is a shortage of skills. Anything in the technical assistance or, indeed, the direct funding area that can assist not just with graduate skills, strengthening the graduate level in these countries, but also at a more managerial level, such as supporting business schools in these markets, would be very valuable—anything in the skills area. We have talked about the infrastructure area. Clearly that is crucial. So many countries are held back by a shortage of infrastructure—power infrastructure, as well as other infrastructure. Anything in that area that technical or budgetary assistance can help should then unlock more private sector activity.

Jan Dehn: I would like to make a few comments on the subject that we have just discussed, with respect to project aid, programme aid and the effectiveness of different types of aid. First of all I should mention that, prior to joining Ashmore, I worked as an ODI fellow in Uganda for two years, working in the Ministry of Finance there, which was obviously a DfID-funded programme. That was technical assistance, which I personally had good experiences with. It was quite effective and good value for money. Prior to that, I had lived for most of my childhood in east Africa, where my parents have worked for various aid programmes. I have worked as a freelance consultant evaluating European Union aid as well. So I have lengthy experience of aid. I also did work on the effectiveness of aid while I was doing my doctorate at Oxford University. So I have viewed it from different perspectives.

My overall experience and broad conclusions would be that project aid is pretty ineffective. Project aid used to be disbursed as components within broad ministry budgets, often flew well below the radar of regulators and was often a source of major disincentives for civil servants, who were often paid far more on aid projects than they were in their civil servant jobs. Often corruption could go completely undiscovered for a long period of time. It was in nobody's interest to end these flows because, on both the aid recipient and donor sides, everybody was interested in just keeping the disbursements going to keep the budget activity up.

Programme spending was an improvement on that old approach of projects. It is true that a lot of programme allocations to particular sectors would often end up in destinations different from what they were intended for. I was involved in developing the first ever public expenditure tracking survey studies at the World Bank and implementing some of the early ones that were done in Uganda, Mozambique and other countries. We found that, yes, quite often very large amounts of money would go to unintended destinations, but we also found that they did not necessarily go into corruption. It was simply because in different layers of government there were different political priorities. For example, with education spending that was earmarked for pupils, once it got down through the system to local district level, perhaps the political priorities there were to do up a rural feeder road that had been washed away in a storm. Then the money would be allocated to roads instead of schools. So, yes, there are issues to do with allocation of funds in programme aid, but I want to make the point that it is not necessarily the case that all this money disappears into corruption.

Q260 Lord Tugendhat: When we had some other people giving evidence, they spoke very slightingly about the role of foreign direct investment, particularly the mining companies. Indeed, if I remember correctly, one of them said that they thought that the net impact was actually negative. I am struck by your talk about SMEs because it seems to me that one of the things that foreign investors do—and, in some ways, the mining companies do above all—is to encourage the development of SMEs in order to fulfil various roles in the supply chain. I think that this is a very positive development. What is your view on that point?

Simon Harford: I would completely agree with you. From all our experience, which is clearly anecdotal on the ground—we have not analysed it systemically across the world—any form of private investment, assuming it is by a responsible investor, is hugely important and valuable, as would foreign investment be, particularly of the long-term form which is also bringing skills. Long-term investment does exactly what you are saying. They have to create sustainable structures in the community, whether they are mining or not mining. That creates massive multiplier effects. Our own businesses that are operating in these markets—the ones that we have invested in—will do exactly what you are saying. They will create local supply chains and local community involvement. This is also much the best way to get the most sustainable business model, so I totally agree.

Q261 Lord Smith of Clifton: I think that you have largely covered this question, particularly Mr Dehn in putting the emphasis on the private sector. Foreign investment, both direct and portfolio investment, into low-income countries has increased very substantially in the past decade. But for the least developed countries it remains overwhelmingly concentrated in the natural resource sectors, transport and communications. What is needed to encourage a more diversified portfolio of investment across sectors, particularly into the more labour-intensive sectors? Is there a role for aid in support of this? You have covered this by talking about the development of skills, graduates and better management levels. That is slightly proverbial; it is a list of proverbs. What do you actually do to bring on the necessary skill base at all levels?

Simon Harford: May I just clarify? Is the question how we solve skills issues in the companies in which we invest?

Lord Smith of Clifton: I think that you were talking more generally, but I am now asking you whether you see, particularly at the SME level, that there are opportunities. How do you bring on the skill levels there? How do you actually go about it, since there is a great shortage of skills at this sort of level?

Simon Harford: If I can give you some examples, in the companies that we invest in we will encourage them to do a lot more training of the initial graduate intake. Obviously how many people they are employing and so on depends on what type of company it is. We often support training and have a training budget in the company. Secondly, we will often support any part of their ecosystem which is providing skills. So if they are drawing staff from certain universities, if they have relationships with certain vocational courses or if MBAs are important to them, we will often support those. Thirdly, there is engagement with Governments. In many countries in which we operate, we have a relationship with our host Government. We will advocate the same focus on education and skills. I do not know if that answers your question, but those are some of the practical things that we would do.

Jan Dehn: I do not see any direct role of foreign aid in encouraging FDI. In fact, I do not think that there should be much of a distinction between domestic and foreign investment. One of the areas where foreign investors have an advantage compared to local investors, particularly in the least developed economies, is where there are very small savings pools. It is very difficult for individual financial institutions, whether they be pension funds, banks or other institutions with small pools of capital, to allocate to larger projects for risk purposes. It will simply be too much exposure on their individual balance sheets, whereas large, foreign institutions often have much larger balance sheets. These projects would be a smaller share of their total assets. Foreign pools of capital have a competitive advantage relative to local institutions, and a risk benefit of being involved in these larger infrastructure projects.

In terms of encouraging foreign investment, there is an important, more general point to make. There is this perception of the question whether aid and our foreign involvement in poor countries are really effective. I would say that the really big transformation that has happened in developing countries over the past 20 years or so is that the economic and political environment in those countries has improved dramatically. That has to do with the end of the Cold War back in 1989. There has been this transformation process in these countries as they have become more democratic and institutionalised, which has resulted in much, much better fundamentals. It is indeed possible that it is not that aid has had a more improving impact on these countries; rather, it is the improving economic and political conditions in those countries that now make it possible to implement aid more effectively today.

The key threat to the continuing improvement that we are seeing right across emerging markets, including the poorest countries, is the volatility that arises particularly from the economic problems in the G10. It seems extremely likely to me that the very poorest countries will see a cutback in aggregate aid flows over the next five to 10 years. It is extremely likely given the fiscal dynamics in the West. Given that a very large proportion of public spending in these poorer emerging economies is financed by donors, the fact that this will happen raises the question of what is going to replace that financing. That is the biggest threat to sustained continuing economic improvement in these countries at this stage.

There is also an issue in that each one of them is very volatile individually. They have weak Governments; they have difficulty protecting their borders; they are commodity producers; they are prone to shocks. They need mechanisms for alleviating potential shocks to their economies.

The underlying political and economic fundamentals in poor countries have improved dramatically, mainly as a result of the end of the Cold War. Our job now, if we have an interest in maintaining stability in poor countries, and I think we do, is to ensure that this development is sustained. That means addressing the issues that can derail development rather than trying to come up with a way of solving a problem that, in effect, has already been solved by the political and economic changes that have occurred over the past 20 years.

Jonathan Pell: Just in relation to mining, we find it slightly frustrating that mining companies are criticised so often for their operations in developing countries. In many of the countries in which we work, it is natural resources in which these countries are internationally competitive. There are no other sectors in which they are competitive. We can put in place longer-term strategies to try to facilitate that competitiveness, but mining is one of the most viable industries in countries such as Sierra Leone or Afghanistan.

We also feel that it is the wrong time to be thinking, "What other sectors should we be working in?" DfID in particular has never really had an unequivocal policy statement towards supporting mining sector governance and improving it. There have been some piecemeal efforts in certain countries. Oil and gas are perhaps slightly further advanced, but we feel that now is the time of growth for solid minerals and mining. Sierra Leone, for example, will leap forward with its GDP growth next year to 50% or 52%; I think that those are the estimates. Now is the wrong time for DfID in Sierra Leone to be thinking about other sectors. Now is the time to be supporting better management of the regulatory framework. Then, once revenue starts to flow for Governments, support needs to be provided for the Government to make good public investments in things like tertiary education and healthcare.

Q262 Lord Forsyth of Drumlean: Just on that point on mining, in earlier evidence we have received a great deal has been made of DfID's approach of not having any conditionality associated with aid. If you look at what is happening in Africa on the development of mining and infrastructure with the Chinese, there is clear conditionality which has a spin-on effect. What do you think about this policy of avoiding conditionality, which is presented as a virtue?

Jonathan Pell: Fundamentally, we think that it is the wrong policy. If you take a sector like mining, where the political economy constraints to reform are significant, it is important to have some conditionality attached to aid in relation to the Government actually meeting some of those targets.

Simon Harford: I want to add a comment to the general question about the role of aid in diversification and to link it back to the jobs question. Broadly, I totally support my colleagues in pushing for private sector, more technical and less money, aid. But I think, on the point that Mr Pell is making, that these economies are all at different stages. If you look through the lens of aid being particularly about technical assistance, what can technical assistance do for the given economy at the stage where the private sector is all fine and at the stage where it still has obstacles? You will still find a whole load of areas where aid, in the form of technical assistance, can help the diversification.

Perhaps I can give two or three examples that we encounter. I can imagine if we had had DfID as a technical assistance partner in the background, helping our efforts in Nigeria, for example. In central Africa, in textiles, we own a business that is a textile producer across multiple sub-Saharan, west, central and east African countries. They produce locally and they distribute textiles. We have two problems. One is counterfeits from China. Imagine if there could be technical assistance, which is beyond our ability and resources to do, to help Governments to strengthen their barriers to counterfeit illegal imports. That would support the local manufacturers and the integrity of African textiles that are being produced in Africa against counterfeits. It is not even always a question of helping the Governments. There are some fascinating social entrepreneurs in Africa who are creating anti-counterfeiting mechanisms for consumer products using mobile phone technology and bar codes. It is fabulous stuff. Imagine if they got a bit of a turbo charge from some technical assistance support to help to build their own businesses. So the social entrepreneur, which is a private sector model, is doing something that is having an enormous enabling effect for all consumer businesses to defend against illegal counterfeits and imports. That would be a lovely scenario, to marry up private sector activity with technical assistance—aid in the form of technical assistance.

With the same business, on the jobs question, we try to encourage the company to sell not just textiles but also manufactured clothes. That requires tailors. So, in response to the earlier question, we are investing to try to create a whole network of self-employed tailors, individual men and women, to tailor the textiles that we are producing. There is more value added, and it also defends against counterfeits because you cannot really import or adapt to the market so readily. So those are just a couple of examples where what I am describing is beyond our ability to do; there are quite a lot of moving parts. But really targeted technical assistance, to complement what the private sector is doing anyway, would be very catalytic.

Let me give one other example, back on resources. We cannot afford to paint resources—mining, oil and gas businesses—as bad, because that is what the economies of so many emerging markets have. They do not have a lot more. Unless we make the most of them and use them as a foundation to then diversify the economy, I do not think that we are helping. We no longer do, but we used to invest in oil and gas businesses. We would put a massive effort into how they created jobs in the local community so that community relations were stable. We have done this in the toughest parts of DRC, Nigeria and so on. Again, the company itself often does not have the manpower or skills to manage those community relations and to go out and spend days, weeks and months talking to the community about how best to interact with the company. So we work with community relations NGOs to help bridge that gap and bring more skills to the subject. If a company manages oil and gas, it is not necessarily skilled at community relations. These NGOs struggle. They are often a few, fabulous people, but they are small. Imagine if technical assistance could spot the good resources companies that are trying to do the right thing, which are ethical and so on. They need more help with community relations, creating the supply chain and so on. There are NGOs that are trying to do that, but if they could be helped, supported, strengthened and perpetuated, that would be another powerful win-win that is at the moment often beyond the ability of the private sector to do.

Q263 Lord Hollick: You made the point that G10 funding may not be sustainable at the current level. To what extent can the private sector step in? I have two thoughts here. The first concerns the work that all three of your organisations do and the extent to which that could be supported by DfID, through direct investments or investments alongside the ones that you make. The second relates to African countries in particular accessing the international markets on a non-concessional basis. To what extent is that feasible? Is it being done at all? Is there an appetite in international financial markets to step in where some Governments may wish to step back?

Jan Dehn: My basic position here is that I very much think that low-income countries should consider tapping into international capital markets. It is possible and the experiences that we have had have generally been pretty good. There are four broad reasons why you want to do this. One is certainly that, for the low-income countries, you need to find some alternative financing when donor flows decline, otherwise you create a financing gap that cannot in the short term be met by tax revenue, because expanding the tax base takes time. That means that you are most likely to turn to a central bank to print money, which means that you get inflation and macroeconomic instability, which destroy your long-term growth potential and any incentive to invest. There is an issue here that needs to be addressed and all donors should take an interest in it, because the performance of their individual projects will ultimately be affected by the conditions in the macroeconomy.

Secondly, donor-recipient countries need to be realistic about the importance of diversification of their sources of finance. There are a number of examples that I can go into, if it is interesting, of countries that have, for various reasons, gotten into international disagreements with donors and have seen donor flows cut off en masse, as individually those countries do not really matter so much as the donors' relations with one another. They can risk losing all their sources of financing if they purely rely on bilateral or multilateral financing. Diversification is important.

Thirdly, it is very important to develop sovereign yield curves, which are a key ingredient in any country's financial infrastructure. They tell you the risk associated with investing in that country. One reason why it is so important to have a yield curve is not so much because you want to finance Governments—ultimately you want to keep Governments relatively small—but so that you can price financing for the private sector. Corporate bonds are essentially the channelling of financing through the private sector, which is really what is missing in a lot of the poorest countries. If you have a sovereign yield curve, you know what the sovereign risk is and then you can price the corporate bond off that yield curve as a spread.

Finally, I think that bond markets and yield curves in general—liquid traded markets—send real-time, important policy signals to policy-makers. It has been the case in Africa for years that every quarter an IMF delegation would come and tell a Government what they think about their policies. You will also have bilateral aid delegations going every quarter to give their view, so you get a million different views, which are often informed by completely different priorities from what is objectively good for that country. A bondholder will typically be focused very much on the long-term sustainability of the country and they will react immediately to policy changes. Bond markets impart those signals to policy-makers immediately.

We were involved in advising the Government of Ghana when, a few years ago, they issued their first sovereign bond. We provided a kind of technical assistance to them. The Ghanaian Government, like most African Governments, are extremely good at managing aid flows. They have years of experience of doing it and playing one donor off against another, but one thing that they had no clue about was how to pick banks and advisers for issuing bonds. A bank would go to Ghana and offer a roadshow—a trip round the world—to sell the country on the understanding that the country would then pick that bank and the bank would probably earn a lot of fees. We were able to tell the Ghanaians at the time, "You might want to consider asking three or four different banks, so that you can get your fees down to a reasonable level. You might want to consider choosing the banks in such a way that they have a large, strong institutional investor base instead of a very narrow set of clients, because the performance of your bond in the after-market, after it has been issued, depends a lot on who ends up buying it. If you have a weak buyer base, the bond will perform poorly in the after-market, which will leave you with a legacy so that next time you issue you will have to issue at a higher price."

There are all these technical factors. Britain, of course, given its importance as a financial centre, has lots of expertise in this area. These are technical factors—very basic things—that many African Governments simply do not have any experience in but which can very easily be provided. The US Treasury has for several years planted a few financially educated people in key positions in a number of African countries to very great effect, advising specifically on the development of capital markets. I think that that is a very easy win. It links in with the whole TA idea and I think that it is a very good idea.

There is one other area where I think we can begin to improve things. Often the biggest resistance to the development of capital markets and bonds in poor countries comes from the IMF. The IMF will often say, "No, we can't have non-concessional financing in poor countries, because they can't pay these higher interest rates." But it turns out that many of these IMF programmes impose a prior assumption on the returns on public investment in those countries. That prior assumption is that the return on public investment is zero. Of course you cannot have non-concessional financing if, when you invest the money, you get a zero return. The truth is that the return on many of these projects, especially infrastructure projects, can be extremely high in economic terms. If you look at the yields at which emerging markets and poor emerging markets can issue, they are not that outrageous. At the moment, Sri Lanka, which came out of a civil war very recently, can borrow 10-year money at 6.6%. Yes, that is not zero or the kind of interest that you get from the World Bank, but there is a healthy element in having to pay interest. That interest will go up and down, depending on the policies that are adopted. Ghana is currently trading at 6.8% yield, Gabon is trading at 5.6% yield and Nigeria is trading at 6.5% yield—these are single-digit costs of financing, which I think are reasonable if one is to expect Africa to grow, given that African countries are growing easily at 5% in real terms a year. That is how I would answer that question.

Q264 Lord Shipley: You have all made the clear case that, if we maximised the private sector, growth would be unlocked. You also have given the clear impression that there are problems around the management particularly of projects with the UN, the World Bank and some government agencies. I would just like to be clearer as to whether you think that the private sector might suffer some of the same governance problems as public funds can suffer. What is the evidence that the private sector would ensure the delivery of better governance within a country?

Jan Dehn: I do not think that the private sector can ensure the delivery of better governance. The private sector operates within the framework defined by government and it can be counted on to exploit every nook and cranny within that framework. It is therefore extremely important that that framework is solid and internally consistent and that it addresses the points at which the private sector might go and where it might ultimately create havoc. Provided that that government framework is well defined, it is in the interest of any country to have as vibrant and as aggressive a private sector as possible within that framework. That is what the opportunity is here. There is a serious momentum in emerging markets in general and in poor countries as well. A lot of the long-term negative influences that have prevailed in that part of the world for the better part of the post-war period have gone. We have the opportunity here to give support, which is something that we should do, but we have to do it with a clear eye to governance and to the regulatory framework.

Q265 Lord Lipsey: The implication of what you are saying is that aid—certainly project aid—should be downgraded in future and that the aid money, such as we have, should be used to lever in private finance for public/private partnerships. Is that a fair summary of your general views?

Jan Dehn: Yes, with one important distinction. Project aid means slightly different things today from what it used to mean. We have, for example, private infrastructure funds in a number of emerging market countries. The fact that we invest in infrastructure, which is very long-term investment, should testify to how credible we find these countries as destinations for long-term investment. As for project aid now, I think that the ideal structure would be something along these lines. Government may, for political reasons, identify the particular sectors where it wants to see development of infrastructure and other things. It should then recognise its own limitations in being able to deliver those types of projects. It should offer the overall guidance, direction and framework. To the extent that there is a public good element involved in that project—in other words, it would not be done by the private sector unless there was some state subsidy associated with it—that state subsidy should be made very explicit. It should be put in the Government's budget and be voted on every year by Parliament, so that Parliament can know what that subsidy is going to cost. Then the private sector should deliver and operate those projects as far as possible. That type of project is, I think, probably the way forward. The old types of project, where you were operating within the public sector to deliver very obscure projects, were a disaster. So I make that distinction.

Q266 Lord Hollick: When a recipient country has a substantial aid programme, in particular a substantial UK aid programme, does this influence the way in which you assess country risk or project risk and ultimately your investment decisions?

Simon Harford: The basic answer is no, but if you go to one level beneath and ask why the aid programme is so large, the answer might vary. If the aid programme is filling a void in a country whose private sector or investment climate is not there, the chances are that, if it is a high-aid environment, a firm like ours or a private sector investor is unlikely to be strongly active, because the economy simply has not reached the maturity of evolution. If, however, the quantity of the aid is in a more advanced economy—Nigeria, for example, receives a large amount of aid but has a big, diverse economy—there is ample room for private sector provision alongside that, because they are probably fulfilling different purposes.

Jan Dehn: For us, as portfolio investors mainly, — we do private equity operations in infrastructure and other areas as well, but my focus is mainly portfolio flows—the size of the UK programme does not feature at all. In general, if a country had a very large aid programme, I would regard that as a negative, as it seriously distorts incentives and so on within the Government and it tends to crowd out the private sector. Once you get to a certain level, I think that it becomes a negative.

Q267 Lord Lawson of Blaby: Could you say what that level is, in your judgment, and to which particular countries that remark most applies?

Jan Dehn: It is hard to define a specific level, because the country-specific facts are so important. However, Tanzania, for example, where I lived a few years ago, had an enormous aid budget. That has since been somewhat curtailed, but I think that Tanzania is an example of a country where aid is a little bit too much and where they would benefit significantly from maybe diversifying their financing sources further in the direction of more market incentives rather than aid flows.

Q268 The Chairman: You talked earlier of Ghana. Would that apply there as well?

Jan Dehn: Ghana will quite naturally find its own sources of diversification, having just stumbled on a big pool of oil, but, yes, I would say that Ghana is also a country that has received a lot of aid. When you go to countries that have very large aid flows, you get a completely different feeling when you talk to government officials. You are so remote—the private sector is such a strange and remote entity—and there is a complete lack of responsiveness to market incentives. On the other hand, some of these countries have been able very successfully to secure from donors a continuous, stable stream of financing at very low cost to themselves. My concern is that the private sector does not really get the best possible incentives to expand and, without market incentives, I worry about the long-term dynamism of such economies.

Lord Lawson of Blaby: Would you be kind enough to send us a note, having thought the thing through, on which countries in your judgment—I cannot believe that it is just Tanzania—are receiving too much aid?

Jan Dehn: Yes.

The Chairman: It would be very helpful to have that.

Simon Harford: Lord Chairman, might I add a couple of comments on this? My experience and our experience as a firm are probably more anecdotal than perhaps my colleagues' and so should be taken in that context. I think that it would be a risk if there is sense that this is binary: either the country deserves aid or not, or it should be money aid or technical assistance aid. My sense is that most countries need a more nuanced solution. I think that perhaps all of us are saying that one should turn it round and ask what a given country would need to further catalyse the private sector and then whether there is a void in that country that the private sector would not fill. We should then tailor a very nuanced aid solution to that very specific question. That would lead you to ask where financial aid is needed, because there is a void of other forms of funding, and where technical support is needed to catalyse the private sector. For example, Nigeria receives, cosmetically, a big quantity of UK aid, but that is in the context of a vast economy and a vast population. By one measure, you might think that they are doing okay but, on another measure, you still have over 70 per cent of people living in poverty. The Nigerian economy is fine in the oil sector in terms of economic growth, but arguably it is not fine in terms of the sustainability of the oil sector because of its community relations. On the other hand, some 30% of GDP in Nigeria is in agriculture. Agriculture in Nigeria desperately needs support because private sector capital is struggling to catalyse that sector, which by the way is also the biggest source of labour. Agriculture is too much still a subsistence model; it is not turning into companies that you can then fund to grow the sector. So private sector capital is struggling, by and large, to move the agriculture sector forward, which is 30% of the economic output and 70% of employment. Then I would ask: can aid, probably through technical assistance, help the agriculture sector in Nigeria? I suspect that the answer is yes. So, if I may, I would suggest a fairly nuanced view, country by country, of the questions yes or no, aid or no aid, money or technical assistance.

Q269 Baroness Kingsmill: I declare an interest as a director of a recently listed company that provides temporary energy solutions in developing and emerging markets. From your perspective, how would you assess the overall effectiveness of DfID as an aid agency? How has that changed over time?

Jonathan Pell: We have to consider how we measure effectiveness. One comparison is DfID versus other donor agencies by looking at whose programmes deliver results. In that respect, DfID is effective and across the industry is seen to be one of the most innovative development agencies. Most important, what drives that innovation is an ability to learn, reflect and change. Often, in an institution as big as the World Bank, for example, changing is quite difficult to do because the organisation is so big.

On the second part of the question, on whether DfID has changed, the answer is: absolutely. We see much greater focus on the role of the private sector, not just in agriculture, mining and those more traditional areas but in new exciting areas such as water. We are just starting a DfID programme in Kenya that is looking to encourage private sector companies to play a part in rural water provision. Five years ago, if you had mentioned the role of the private sector in water, you would have been accused of being a right-wing loony—

Baroness Kingsmill: You mean that your descriptions have changed.

Jonathan Pell: That is right. Other sectors that we see as being exciting include health and education. Again, previously those were not considered as areas where the private sector could be involved, so DfID support for education, for example, would have meant working through a ministry of education and our success would have been judged on how many textbooks had been handed out. Today, there is much greater consideration for the role of the private sector. I am thinking of Nigeria and Bangladesh as two examples of where DfID is looking at the role of the private sector in education.

Baroness Kingsmill: In your view, is that the right balance?

Jonathan Pell: Absolutely. Another change that we have seen is that infrastructure is definitely back on the agenda, which is very exciting. Also, as I made reference to before in relation to the Select Committee report, DfID is acknowledging that its key strength is advising on the governance arrangements to facilitate private sector investment, which I think is absolutely crucial. Of course, infrastructure has a large multiplier effect on any economic sector and it has massive social benefits as well.

Other changes that we have seen recently include a much greater focus in programmes that we deliver on achieving results and being able to demonstrate impact. There is now a much greater threat that DfID will cancel non-performing programmes, which I think is absolutely the right thing to do. We also see much greater focus on value for money, which until recently has really lacked definition. Unfortunately, it was interpreted simply in terms of economy and reducing costs, but there is now greater consideration to value for money being defined as effectiveness of programmes as well.

Baroness Kingsmill: So there is a greater focus on outcomes.

Jonathan Pell: Yes, that is right.

Q270 Baroness Kingsmill: As a corollary to that, what do you think are the benefits for the donor countries in this context? The benefits for the recipient countries are pretty obvious, but how would you describe the benefits for the donor countries?

Jonathan Pell: UK taxpayers might see development being about handing out malaria nets or humanitarian assistance, but, as aid has diversified and DfID is doing more innovative and exciting things, there is a greater understanding that this is about not just providing humanitarian assistance but creating economies that are sustainable. Ultimately, that will mean that, as development partners and as donors, we can exit. By catalysing private sector growth, there is an end game, so aid would not be endless in that respect.

Q271 Baroness Kingsmill: And do you feel that it is appropriate to have a specially designated ministry administering this sort of business development?

Jonathan Pell: Absolutely, yes.

Jan Dehn: Can I make just one quick point? What is likely to happen in all emerging markets, including the poorest ones, is that growth going forward will need to be less export led and more domestic-demand led. In order to provide strong domestic-led growth, you definitely need infrastructure, which should be a clear priority. However, there are huge obstacles, as developing countries are poor at delivering infrastructure.

What will also happen, as domestic demand picks up in those countries, is that they will no longer run such big external surpluses and may even run current account deficits, which need to be financed. Therefore, when aid flows are curtailed, there is a double problem: the current account deficit is bigger while the country's financing sources disappear. This issue needs to be addressed. Donors should focus on trying to develop market solutions to finance these future deficits.

Another, more general point is that donor agencies need to wake up and smell the coffee. The world really is different from the way that it used to be. It is not like there is a whole bunch of people out there who, without us, are helpless so we need to go and help them. There is a dynamic in emerging markets that is very strong and is perfectly sustainable, because they do not suffer from the deleveraging disease and all these horrible things that we in the G10 have. We can go in and tailor our programmes to where we see the specific constraints, which will be unique to each country.

In general, the benefits to us in the West from engaging in aid are seen in very general ways. It is advantageous for us to have strong growth in emerging markets at a time when we do not have strong domestic growth at home because of the fiscal difficulties that we are going through. It is beneficial for us—depending on your political perspective—because, generally speaking, immigration is an issue. If you can create growth in emerging markets, people generally do not want to leave if they can have decent conditions where they are. Certainly, given other more intangible issues such as terrorism and other factors, there are plenty of grounds for wanting to see growth in countries where there has been no hope and no future. Those are some of the very broad benefits that could accrue to us if we assist that process of development.

Q272 Lord Moonie: Do you think that the Government should build into legislation the requirement that we spend 0.7% of our gross national income on overseas aid?

Jan Dehn: No, I do not think that the Government should. Personally, I do not think that it is a very good idea to earmark any kind of spending; budgets should be flexible so that they can adjust to needs. The 0.7% target is also an arbitrary number. Ultimately, we want to get to a situation where nobody needs aid at all, so I do not think that putting that into legislation would be particularly helpful.

The Chairman: Are there any other views?

Jonathan Pell: I am not so sure that 0.7% is an arbitrary number; it is a target that most developed economies are working towards. The British Government have made a strong commitment to meeting that target, so it follows through that it should perhaps be put into legislation. We are not far off the target, so we are doing pretty well, but at this time when the pie is getting smaller that is a relevant question. To reduce development spend now would be the wrong time. I have talked about innovation and trying new things, and I think that now is the time to ramp up because people have learnt from implementing DfID projects. I think that the results and impact that are coming through from British development assistance are getting better.

Q273 Lord Forsyth of Drumlean: How does its being a target not make it arbitrary?

Jonathan Pell: I mean in the sense that it is an agreed target—

Lord Forsyth of Drumlean: But it is still an arbitrary number.

Jonathan Pell: In that sense, yes.

Simon Harford: I would just add that, a bit like the marketing budget in a company when times are hard, the aid budget is sometimes the first budget to be hacked away. I personally subscribe to Mr Dehn's view that legislating might be the wrong answer, but allowing the target to slip down to zero in tough times would also be the wrong answer. Whatever mechanism is adopted to ensure that the aid budget does not get the proverbial marketing budget treatment is important. What the correct number is I have no idea, but I think that there is a clear thrust from all of us that it is probably moving more towards technical assistance than pure cash. As a private sector business battling away in these markets to try to invest and build companies, we need technical assistance and there is a lot to be done. Having smart, forward-looking aid of whatever number is still a necessity alongside the private sector.

Q274 Lord Tugendhat: Let me just take up that question about 0.7%. If we go from where we are now—which I think is 0.52%—to 0.7%, would the amount of additional resources that that involves actually make a tangible or significant difference? Are we perhaps getting fixated on a target rather than on how resources can most effectively be used?

Simon Harford: Personally, I completely agree. I would judge what the right answer is in terms of the effectiveness of outcome. I have no idea what the right number is.

Lord Tugendhat: That is exactly my position.

The Chairman: I am afraid that we have a Division in the Chamber, so we will need to adjourn for about 10 minutes, but we will come back as quickly as we can. We have a few more questions, so please be patient and we will be back as soon as possible.

The Committee was suspended for a Division in the House.

On resuming—

The Chairman: Gentlemen, may we resume? We have a few more questions that we would like to ask you, if you would just be patient.

Q275 Lord Best: My question is about corruption. We ask nearly everyone who comes to give their views on ways in which something might be done about it as an issue that affects donors and the whole aid programme. I thought that it might be interesting to hear your views on whether or not the corruption that varies from country to country makes a significant difference to private sector investment and engagement, or whether the private sector is able to find an accommodation in ways that perhaps we are not with respect to the level of aid. To what extent is corruption a big issue in securing and supporting private sector investment into these developing nations?

Simon Harford: I suspect that we all have strong views on this.

Baroness Kingsmill: The same views, I would hope.

Simon Harford: I would answer that it is a massive issue. My view, and my firm's view, is total zero tolerance. One absolutely can operate in virtually all of even the corrupt countries in a clean way. Many of the African countries in which we operate are labelled as highly corrupt countries, but we invest there and we do so on a zero tolerance basis. Yes, I agree that there is a huge problem, but one can still operate cleanly. As long as you have the right intent, you can operate cleanly, even in highly corrupt countries. I do not think that DfID or any other donor should accept any material level of corruption at all. I think that all donors should have absolute zero tolerance as well, with a couple of caveats. There is obviously an element of materiality here. The companies that we own collectively employ something like 100,000 people. We as a firm are obsessive about anti-corruption, but could we vouch that not one of those 100,000 people somewhere has made a facilitation payment to get some piece of paper? Of course we could not. But when we encounter anything of any materiality, do we make a big stink, fire the right people and make it crystal clear that we do not tolerate it? Yes, we do. I suspect that there has to be some level of materiality, but in my view the intent should be absolute. One advantage of handing over technical assistance rather than cash is that it is less susceptible to corruption, so there is a natural link to the other main theme that you are hearing from us.

Jan Dehn: I entirely echo that: you absolutely have to have a zero tolerance policy towards corruption and it is entirely possible to operate in these countries without engaging in it. It is probably easier for someone like me, who is doing portfolio flows, but we trade bonds that are listed on exchange, where it is all electronic trading. In the last few years, the Nigerian government bond market has developed yield curves out to 20 years. It is liquid and there are many market makers; they are all competing and it is all very transparent. On the other hand, private, individual financing arrangements between the Government and individuals or whatever will be a lot more prone to corruption. That is precisely one reason why one of the major focuses of any aid programme going forward should be on capital market development and developing the key institutions that are associated with that, particularly market makers, repo operations and pension fund development. That is extremely important, so that you get that transparency and multiple market makers.

Q276 Lord Best: Is there any read-across from the ways in which you can operate a zero tolerance policy to the ways in which Governments—DfID in this case—can behave differently from how they do now? Do you see things that you feel, from your perspective, could be done better or could be changed in terms of not tolerating corruption but still delivering programmes that the Government want to get across? Can DfID learn from you?

Simon Harford: I have a few thoughts on that. I am sure that there are things. One of the benefits of the private sector is crystal-clear accountability. If I know that I will get fired for being slack on keeping an eye on corruption, that focuses the mind. We are a regulated business and we know that we will be shut down if we allow corruption or are slack on the subject. The sheer disciplines that the private sector must operate under are not always as clear in the public sector or in the donor world. I suspect that anything that can be transferred of sheer discipline, accountability and focusing the mind would help. We talked about obstacles to the private sector. Corruption is a massive obstacle because most of us who want to operate cleanly will simply not invest if either the wider environment or the specific country is corrupt. For DfID and others to be banging the drum on corruption and making a big stink about it is hugely valuable, because it puts their voice there that it is bad and is inhibiting growth. The other point that I would make is that corruption is not just public sector officials stealing public sector money. Sadly, it is also the private sector bribing the public sector. More can be done to put the pressure on the private sector to stop the bribing. Clearly it is not universal. There are many, many companies operating very cleanly, but there are others that are not. The more that DfID or any other entity can increase the heat on private sector companies that are not behaving ethically, the more it would help, in my view.

Q277 Lord Lawson of Blaby: May I follow up on something that you just said, Mr Harford? You said that it is good if government aid agencies such as DfID are banging the drum. But banging the drum is not much use, is it? You first have to police very carefully the aid that you give. Then, if you find that there is corruption, you take action, which may mean cutting off the aid and giving it to some other country that is less corrupt. We have had evidence that suggests that of course they will say that they operate zero tolerance—they will bang the drum, to use your expression—but in practice they do not do much about it. Is your experience similar? Does it support that kind of evidence, or do you feel that there is effective action by the aid agencies, in particular DfID? DfID may be the best in the world—I do not know—but anyhow DfID is ours, so we are particularly concerned about it. Do you think that they are really doing everything that should be done on this front?

Simon Harford: I do not have any personal experience of seeing whether or not they follow through on it, but I totally agree with your point. I say "banging the drum" but that is not of itself sufficient; one has to follow through, measure and monitor and then have accountability on both sides if funds are being misused. I agree that it is both talking about it and acting on it.

Q278 The Chairman: Mr Harford, you have a very clear view about corruption. Does that in some cases lead you to competitive disadvantage in certain countries? Are there countries that you avoid altogether because of the high degree of corruption?

Simon Harford: Yes and yes. We have a very strong moral view, but we also have a very hard-headed business view that, while in the short term behaving unethically might give someone a short-term advantage—whether it is a country, a competitor to us or a company that wants our capital—in the long run it is bad business sense. We accept that short-term consequence not only morally, but also in that we believe and have evidence that it is good business sense in the long term.

Jonathan Pell: It is important when we talk about corruption to make reference to some of the transparency initiatives that DfID has been working on. One that we have been closely involved with is the Extractive Industries Transparency Initiative—the EITI. I think that it is fair to say that it has been pretty effective, certainly in balancing what the companies say they pay with what the Government actually receive. In that respect, yes, it has been effective. But the potential for corruption in the extractive industries goes far beyond just those companies that are producing and assessing transparency at that point. There is a whole range of other transactions and deals in the sector that EITI does not cover. It is important to look beyond these transparency initiatives to the wider regulatory environment, which is important in these countries in stamping out corruption.

Q279 Lord Forsyth of Drumlean: We touched on this earlier when I asked you about China. China, India, South Korea and Brazil have all emerged as new donors. How do you think that that should alter the way in which the UK organises its aid programme, if at all?

Jonathan Pell: When you start to think about China, Brazil and India, you need to consider that, if we refer to development agencies or donors, these are not homogeneous. At one end of the spectrum you have DfID, which is mainly a provider of technical assistance and financial support. You have development banks, which lend money. Chinese companies and the Chinese Government operate in a very different way: it is essentially built around getting a return on infrastructure investment through natural resource concessions. There is a whole range of ways in which these different donors work. In terms of how the British Government can adjust, it is important that it acquires new ways of working. In particular, in Zambia, for example, which has a lot of Chinese investment, it is difficult for DfID to get traction with the Chinese Government or Chinese companies. It is important to look for a different party which can gain traction and which is able to act as a vehicle for the translation of DfID policies. One example is the World Wide Fund for Nature, which very interestingly has a lot of traction with the Chinese Government and Chinese companies. It is able to put forward a lot of policy recommendations around environmental management in Africa.

Simon Harford: I think that the question is very important, because we see in our markets the whole time new donor nations—or you can call them competition for resources, funding opportunities or the influence that these activities bring. It is a very genuine issue. My view is that the UK should play to its strengths. We probably do not want to get into an aid or technical assistance discussion like, "We will build that railway in return for that oil block, please", which is the sort of discussion that is happening with some other bilateral discussions. That is not really playing to our strengths and is not really aligned with the national interest as to why we will maintain our aid. What plays to our strengths are some of the things that we have been talking about. If we are providing aid/technical assistance not just because it is morally right but because it has hard national benefits, or if we are providing that technical assistance or regulatory support on capital markets or banking regulations, or advisory support to SMEs from a venture capital or mentoring point of view, or PPP support—we are a nation that has been through the PPP journey and we have learnt our lessons, both good and not so good—all those examples of technical assistance play directly to our strengths as a nation. We have those skills and are seen as world class in those skills and others. If that is what we are offering in return for the invitation to come in and provide the support, that is a competitive differentiation that we have. I believe that that is an area that should be thought about as we look to the future of how we structure our aid.

Q280 Lord Forsyth of Drumlean: What is the difference between saying, "We're helping you, so you give us the business," which is in this case financial services-related, and the example that you gave about oil or natural gas resources?

Simon Harford: I may have been confusing. I am suggesting that if another country, say China, is providing support for a country, which is removing the role for us, and we are concerned about that displacement, we may not want to talk on the same terms as China with that country, which is not always but sometimes a quid pro quo of resources for aid or infrastructure support. We want to change the conversation and the proposal to why a country should invite in our aid as opposed to another nation's.

Lord Forsyth of Drumlean: The root of my question is whether we should be using our aid programme in order to promote British commercial interests in the way that some of these countries clearly are.

Simon Harford: Yes. That is my view.

Lord Forsyth of Drumlean: Right. But you gave the example of the oil field.

Simon Harford: As an example of what another country is doing. I am saying that we need to promote our interest. I believe that it is right that we are using aid to create the relationship and influence, as well as the benefits of, aid, but we must play to our strengths and what we can offer.

Q281 Baroness Kingsmill: I am sorry, but I am getting a bit confused here. Are you saying that it is a good thing that the Chinese, for example, say, "We'll build your railways, this village and a school if you give us the rights to extract minerals from your country"? Is that good or bad, corrupt or incorrupt?

Simon Harford: I am not saying whether it is good or bad; I am saying that it exists.

Baroness Kingsmill: Should we be doing it?

Simon Harford: No. I am not saying that.

Baroness Kingsmill: Is it corrupt?

Simon Harford: I cannot comment on that. I do not know.

Baroness Kingsmill: Okay. I am just trying to get an understanding. I can quite understand corruption when there is baksheesh and money in the back pocket. But is offering to build or help to build the infrastructure of a country in return for a resource—the right to mine or whatever—corrupt?

Jonathan Pell: No, it is simply a different way of working. DfID's strength lies in, as Mr Harford said, staying focused on its strengths, such as advising on the governance aspects. No, I do not think that DfID should get involved in the Chinese way of working, but given that DfID has large aid programmes in the countries in which the Chinese are investing, it should stay focused on improving governance so that those contracts that are formed are transparent and deliver to the best of their ability economic and social returns.

Baroness Kingsmill: That is a bit blurry, if I may say so. Is there any reason why we should not operate in the way in which the Chinese do?

Simon Harford: I think that there might be. I do not feel qualified to comment on all the ways in which China is interacting with developing countries.

Baroness Kingsmill: We have used it simply as an example: "We will help you build your railway if you give us the rights to extract this mineral that we need." Is that okay or not okay? Is it desirable or undesirable? Is it corrupt or not?

Jan Dehn: I would like to offer a perspective and then we will see where we will take it from there. I do not see these BRIC economies—these wealthier emerging markets—as being donors. I see them as being business partners in the countries where they operate. That is a great thing. Where I see these countries being donors is when they lend money to the IMF so that they can bail out Europe. That is what Brazil is doing, and that is what they will be doing at the G20 summit. That is aid. What they are doing in Africa is business and that is perfectly fine. My own view on whether we should do the same is that I do not think that we should use aid as a way to promote trade. I think that trade and aid are two different things. I do not think that we should use aid in our national interests. If we have a soft spot for people who are poorer than us, then we should be frank about that and say, "Okay, this is the money we are allocating to help, specifically for charitable purposes." That charity, in order to be most effective, should address the key constraints that prevail within those countries. If we want to have an active trade policy as well, that is where our national interests should be expressed.

Q282 Lord Forsyth of Drumlean: Forgive me, but I think that you are ducking my question a bit. If fostering domestic and international private sector involvement is part of DfID's objective—and we have spent the whole afternoon talking about that—is there not at least a question whether DfID, carrying out all its functions, should not at the same time actively set out to promote British commercial interests? Mr Harford referred to the BRIC countries and others almost as competitors as sources of capital and sources of investment. Baroness Kingsmill has talked about the Chinese saying, as she put it, "We'll build you these roads if you give us these mineral rights." That is a very crude proposition, but if they are saying, "In order to develop your mine, we need to have these roads; we will build them and that will have all kinds of knock-on infrastructure effects, but by the way you've got to use all these Chinese companies to do this," that is cutting out British companies from a process that is being initiated. Where is the balance here?

Jan Dehn: Of course, it is always tempting, if someone else uses their Government to promote their businesses and thereby those businesses gain a competitive advantage over one's own, to say that one should do the same. While that might work in the private interest of our own individual businesses, it is certainly not in our national interest to continue to do that on a grander scale, because it is a very inefficient allocation of resources. In the long run, you end up having to subsidise everything and the whole game becomes about who can lobby the hardest to get the next chunk of DfID money to get a subsidy. I remember clearly that, when I was in Uganda, the Spanish were building the airport at Entebbe. We were evaluating the value for money that the Ugandans were getting for this project. One thing that they insisted on buying was baggage trolleys from this Spanish company. We found out what the unit price was for the baggage trolleys and then we checked what the unit price was for a baggage trolley on the free market. It transpired that this aid project was buying baggage trolleys at four times the world market price. In other words, there was a huge implicit subsidy for that Spanish construction company coming straight out of the Spanish aid programme. That means that ordinary Spaniards are going to be taxed in order to provide a subsidy for this particular Spanish company. That is not in the interest of the Spanish economy, in a similar way to its not being in our general interest in the UK economy to tax everyone in the UK to give money to a particular company so that it can gain a contract as part of our aid budget.

Simon Harford: May I briefly add to that? While I completely agree that, if we are going to give aid, it has to be judged on its own merits and its effectiveness and it has to stand or fall on its own business case, I believe—if I understand the direction of your question correctly—that there is a spin-off benefit from the UK or DfID having a healthy aid relationship with a country. As for how UK companies wishing to operate in that country are finding the attitude towards them in that country, I do not think that you can point to a direct causal relationship, nor do I think that you should—the aid has to stand or fall on its own logic—but I believe that there is a halo effect that is of value to British companies if that country has a healthy and positive relationship with DfID.

Lord Forsyth of Drumlean: Just to pursue your trolleys, surely that is different from, if an airport is being built, for example, encouraging British firms to tender for the work. Clearly, if people are paying four times as much as they should be, they are off their trolleys, literally, but that is an argument about transparency and the way in which the business is being done. If there is a good business case for building an airport in Entebbe or wherever, it does not preclude DfID from encouraging British companies to come in and perhaps help to create other businesses and other infrastructure. Do you agree?

Jan Dehn: I agree that encouragement is always a good thing. The question is which form the encouragement takes.

The Chairman: We have come to the last question.

Q283 Lord Lawson of Blaby: Opinion surveys say that a majority of the British people think that there is too much spending by the British Government on overseas aid. One assumes that this majority view is likely to grow as other forms of public expenditure over the coming years get cut back while aid is forging ahead, and growing even more if Mr Dehn is right that other G10 countries are going to pull back on aid while the United Kingdom is forging ahead. Mr Dehn also said that the objective of aid should be the exit from aid because the country no longer needs it. Do you think that the exit from aid along the lines that you were suggesting, rather than increasing aid, would be a more sensible objective if it was explicit?

Jan Dehn: As a very long-term objective, that has to be the objective of any charity. However, putting a number and a timeline on it is difficult. The risk you run is that, for example, if you pull the rug on an aid programme at a time when there are clearly no alternatives, you are destabilising the situation and making conditions worse. Then you are not achieving anything at all. I think that the way forward here is to take a slightly different perspective and look back into these countries and focus much more specifically on the individual constraints that apply in each individual country. That may in some cases give rise to spectacular savings, whereas in other countries it might give rise to a conclusion that one should add more.

The broader issue here is that, given the improvement in the conditions that apply in general within developing countries, you could make an argument that aid can operate more efficiently in countries where there is good governance than in countries where there is poor governance. In that case, you could even argue that it could justify more aid, provided that it is in the right place. The broader point is that we need to modernise and smarten up how we apply our aid programmes and tailor them much more to the conditions that prevail now, rather than operating from the perspective that we have come with and which has been so entrenched in the way western countries look at aid—namely, we always ask the question, "Has aid created growth in these countries?" Aid can now contribute to growth, but only because the conditions there are a lot better. An overhaul, to take a completely different perspective on the aid programme, is entirely justified. What that means in terms of the overall allocation is more of an empirical question.

The Chairman: Does anyone else want to comment? No. Thank you very much. Gentlemen, this has been a very helpful afternoon from our point of view. You have given us a different perspective from that of some of our other witnesses in this inquiry, with clarity and clearly based on a lot of practical experience. We are very grateful to you indeed. I thank Mr Harford in particular, because I understand that he has flown from Johannesburg just for this session. I hope that it been worthwhile from his point of view; it certainly has from ours. To Mr Pell, again, thank you for your written evidence. Mr Dehn, we look forward to getting your short written contribution on the issue that Lord Lawson asked you about. Thank you very much indeed.

Africa Delivers—Written evidence

The below is based upon my most recent posting on http://johnnelsonblogs.blogspot.com/
More background is available on www.africadelivers.co.uk
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Blame politicians and bad aid for increasing famine in Ethiopia, Somalia, and Kenya, and perpetuating poverty in the Congo Basin

Once again we are being assaulted by the news of another impending famine in the Horn of Africa, with up to 10 million people affected, says the UN. Ordinary people from Somali, Ethiopia and northern Kenya are on the move in search of food, with many ending up at one of the feeding centres and refugee camps concentrated across eastern Ethiopia and northern Kenya. There is a public plea from humanitarian agencies for more resources to keep people fed as the crops fail and their animals die. The public campaign is on.

Andrew Mitchell from DFID announced last week that the UK has pledged UK£31 million to help feed millions of people over the next 3 months. And In March 2011 the UK government announced that Ethiopia had been moved to the top of its list of preferred recipients for development aid. The World Food Programme is already feeding 4.3 million people in Ethiopia, and this figure is now set to rise dramatically. This all sounds like just another African disaster caused by poverty and environmental crisis, accompanied by the predictable response from an aid industry grown up in Ethiopia in the 1980s.

We have seen it all before - in my mind's eye I already see the donor fatigue settling in a few years as public interest wanes. Meanwhile a new wave of young pop stars will ride off into the sunset on a giant wave of charity pop fame. Never mind the truth, nor the solution.

What is clear from the most recent research is that the current drought affecting Ethiopia, Somalia and Kenya is not the worst ever, but probably the worst in decades. The dead cattle in the dust are early signs. And I know well from travelling with them that semi-nomadic agropastoralists have always gone long distances in search of water and pasture. But now they are going further than anyone remembers.

This traditional famine narrative has already been covered by the international press, Additional titillation is also being drawn from the climate debate, so expect predictions of figurative tornados and hailstones amidst the cracked soils. There is a convenient natural tragedy story to go with the video news package, and strong images of illness, death and environmental degradation to pull in public interest. The newspack has moved in.

What is currently absent from the news coverage is the way the Ethiopian government is using aid to try to clear dissent from the Ogaden region along the border with Somalia. The native Ogadeni peoples have been itching for autonomy since their lands were handed over to Ethiopia by the British in the 1950s. Their Somali roots makes it easy for the government to associate them with Al-Quaeda linked militias based in Somalia, who the Americans are supporting Ethiopia and the African Union to control. The Ethiopians should be well–equipped for this little clearance job, since last year the US government gave them over half a billion dollars in aid. The fact that oil has been discovered in the Ogaden region further binds everyone into this conspiracy, inadvertently propped up by relief agencies struggling to keep innocent people alive.

And to be fair, the Ethiopian government has used some resources effectively, mainly to improve its own security, and especially by controlling dissent. Just last week they arrested two Swedish journalists who were investigating human rights abuses by the Ethiopian military in those border areas. The local communities' allegations include the clearing and burning of villages, murder and rape, which combined with the ethnic element, sounds a bit like genocide to me.

Such stories have naturally helped to drive people from both sides of the border into desolate feeding camps in Kenya, hundreds of miles away from their customary areas, so confused and destitute they walk straight onto our TV screens. Since there is also another drought, their journey is even worse, so children and the elderly suffer terribly, hence the emergency requiring our prepared response.

Such droughts have been good to Ethiopian elites over the past 25 years. They have built an enviable aid infrastructure that conveniently meets their needs, and those of the hundreds of expatriates involved in palliative relief operations or development talking shops. Between 1999 and 2009 the US provided around US$ 4.7 billion in aid funding. In 2008, at US$3 billion annually, Ethiopia became one of the largest global aid recipients, and this figure is now said to have reached US$7 billion. When I was there last year the hotel industry in Addis Ababa was booming – aid conferences and accommodating foreign consultants are lucrative businesses that generate significant benefits for the few. Does it make sense to increase Britain's aid to Ethiopia at the expense of other aid to other more needy countries?

Meanwhile abject poverty amongst the mass Ethiopian citizenry has remained the norm, with few improvements for the very poor majority despite the billions of aid that have been spent in Ethiopia over many decades. Strangely it seems that military aid has been better used. Maybe political stability and compliance is easier to improve than child mortality and education.

Even where the natural environment is rich beyond dreams, in the Congo Basin, for example, rural people continue to languish in poverty. Even in the poorest region of Ethiopia, you will often find wells and pumps where people draw water. In most Congo Basin communities, however, people continue to drink and bath in streams in the bush because there is no other option. Since most of these creeks are contaminated by bacteria and other parasites, illnesses prevail in rural communities, but medicines are not available, and hospitals often several days walk away. I have seen people dying in wheelbarrows as they were delivered to hospitals.

The big problem the Congo Basin shares with the African Horn is that most aid funds are hoovered up by urban elites – especially when they are provided directly to governments or government-dominated donors – as Britain has done consistently. A good example of this is the UK£50 million the British government handed over to the African Development Bank under the auspices of the Congo Basin Forest Fund (CBFF) – one of the outcomes from the Stern Review on costs of climate change. After several years of inefficient disbursement, during which I have travelled extensively in most of the target countries, I challenge anyone to identify any direct benefits to rural forest peoples – the poorest of the poor in the region

- from the CBFF. The British Public would be shocked to know how much of that forest fund has been consumed in urban areas – where there is little forest. This seems a crazy waste of money in a region desperate for investment.

Of course it is not a waste if one is targeting urban areas. However in Congo, and especially where armed conflicts have disappeared, private investment in buildings is actually at an all time high. Go to Kinshasa and you will see buildings mushrooming while the government roads continue to fall apart. Outside the big urban areas the roads fell apart decades ago, so public investors like the World Bank and China are pouring millions into infrastructure development – In China's case this has been done in exchange for natural resources often located on rural peoples' lands. Typically about 90% of revenues from the sale of natural resources like timber has been kept by government, who do not invest in rural areas – so at least the Chinese will leave roads behind. The only other aid funds effectively targeting rural areas are aimed at urban health centres in small towns, which are still out of the reach of most rural people.

We all have a duty to help end the famine in the African Horn, and I am sure that the Western public and governments will give generously to try to keep people alive. By doing this we signal our common humanity and duty to take care of our fellow man. I also believe that Europe has a duty to invest resources to ensure that Congo Basin folks, who share our time zone and follow our football teams, will all have access to education and health care one day soon. However in order for aid to make this happen it has to become much smarter.

We should not prop up political leaderships who abandon their people. Bad aid does just this.

John Nelson
Director
Africa Delivers
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July 2011

Ashmore Investment Management Ltd, Actis and Adam Smith International—(QQ 252-283)

Transcript to be found under Adam Smith International

Jan Dehn, Ashmore Investment Management Ltd[10]—Supplementary written evidence

Which countries should have less aid?

Introduction

Today aid operates in a radically different context than just a few years ago. Governance and growth prospects in poor countries are improving radically and sustainably. Public finances in donor countries meanwhile are deteriorating sharply. This new context has profound implications for the volume and structure of aid going forward. As aid volumes decline, countries with heavy dependence on donor flows face a financing gap, a de facto ticking macroeconomic time-bomb. Donors have an interest in and a moral obligation to help recipient countries find alternative sources of finance. These have to come from the private sector.

Aid must also be structured differently. Now is a good time to take seriously the development of the private sector. Private sector job generation is the only sustainable way to eradicate poverty. Aid is not a necessary condition for development. But in a better macro environment aid can relieve important constraints to growth. This will mean less aid for some countries, but possibly more for others. The net effect in each country is an empirical question. The starting point for assessing the role of aid has to be a well-grounded understanding of the new political and economic reality in developing countries. Aid should chiefly target the main constraints to private sector investment and aim to alleviate the effect of shocks. Aid is and always ever was the hand-maiden to growth, not the engine.

The shifting impediments to growth in poor countries

The principal impediments to development in poorer countries have changed significantly over the post-war period. There have been three broad phases. In the period leading up to 1989, the fundamental obstacle to development as well as aid effectiveness was the Cold War itself. Superpowers bent on maintaining their spheres of influence in the Third World kept friendly despots in power, with scant regard to the quality of economic policies, human rights, and living standards. There was no fundamental democratic accountability, widespread economic mismanagement, deepening poverty, and political instability. Aid had no statistically demonstrable positive effect on growth over this period, because the economic and political backdrop both militated against any kind of aid effectiveness.

A second phase began in the 1990s, when most poor countries undertook difficult but necessary adjustment following the excesses of the Cold War period. The 'medicine' included debt relief, accompanied by tough conditionality. Attempts at democracy began during this period, sometimes failing spectacularly, but slowly taking root. Aid effectiveness was still tough to prove: aid was used to encourage the adjustment process and democratic practices and alleviating suffering among the most vulnerable groups caught up in the tough adjustment process. But it was still impossible to identify a robust 'aid' effect amidst the turmoil of recession and structural reform.

[10] London, 8 November 2011

By the 2000s, the adjustment process was largely accomplished. Democratic accountability in various shapes and sizes had become the norm rather than the exception in most developing countries and a period of sustained economic growth and stability ensued. We now think of these countries as 'frontier economies' rather than 'the Third World', or 'less developed countries'.

Much improved economic and political conditions, not aid, were behind the success. The reason why democracy in poor countries, so long slated as impossible by Cold War warriors, has been so effective in generating development is both simple and compelling: poor people have no access to social security or unemployment benefits or inflation hedges. Poor people therefore strongly prefer economic stability. Poor people are also far better informed about their standing in the global income distribution on account of information technology. The poor therefore also have a strong preference for growth. Any government wishing to be re-elected must heed this desire for stability and growth. This explains why poor countries in particular have pursued prudent macroeconomic policies over the past decade. Prudent macroeconomic policies are a product of poverty and it is precisely what the private sector needs in order to lead the growth process.

The challenge to aid today
The impediments to development today are, like the constraints of the past, unique. It is critical to sustain the current positive economic and political momentum in emerging markets. The single biggest threat to development is the economic malaise in G10 economies. Aid today should therefore focus especially hard on pre-empting and alleviating any adverse effects of the G10 shock on poorer countries.

The G10 situation poses three specific threats to development:

First, growth will be slower. G10 growth rates will remain well below trend for many years to come. G10 still comprises 50% of the world economy, so frontier economies will inevitably feel the chill. Weak demand in G10 drives down commodity prices and hurts exports.

Second, G10 aid agencies will be forced by fiscal constraints to curtail aid flows over the next few years. The aggregate impact of reduced aid from across the DAC countries will be substantial. Poor countries without well-developed capital markets will face financing gaps, which they will not be able to fill short term through the usual channel of taxation, because tax bases can only be expanded slowly. Unable to tap private sector finance, governments will either cut spending or print money, neither of which is desirable, given the size of the problem.

Finally, G10 policy makers are reforming their regulatory environments in a bid to prevent future crises, but the reforms may also end up impeding capital market development in poor countries. Basel III and Solvency II discourage bond issuance in frontier economies by imposing much higher capital charges on lower rated issuers. Discouraging flows of funds from G10 to frontier markets is myopic, because G10 needs strong domestic demand in emerging markets to help exports at a time of weak domestic demand in G10.

Implications for aid policy
A root and branch reform of aid is required. The starting point is to change perspective. Frontier economies are poor, but self-sustaining, and they have choices. Aid is not essential

and competes with private capital flows, FDI flows, and other donors. Aid can help to deal with problems, but that is about it. If G10 countries wish to give charity at all, they must focus on addressing the most important constraints and risks. Aid can help to sustain and accelerate growth in recipient countries, but it cannot lead the growth process. Donors must recognize their diminished role.

Big aid in particular, that is, where donors are the biggest players, now belongs in a bygone age. Yet, some countries are still massively dependent on aid. Heavy dependence on aid constitutes a systemic macroeconomic risk, especially in the poorest countries, where there are no alternatives and a sudden stop in flows could cause massive fiscal and economic dislocation. To reduce this risk and to ensure the continuing transformation of frontier economies into fully fledged emerging markets donors need to focus aggressively on promoting a greater role for the private sector. The potential to increase the private sector role is enormous. For example, ODA finances 21% of total government expenditure in Sub-Saharan Africa, but only 1.7% of total expenditure in 28 of the most traded emerging market economies.

The transition to lower aid must be executed carefully, coordinating with other donors. Active and aggressive work must be undertaken to identify and harness private financing alternatives. To this specific end, there are several easy steps which can quickly be implemented.

The most obvious step is to assist poor countries in tapping global capital markets. There is no better time than now. Interest rates are at a historical low, which means that poor countries can lock in term financing at very reasonable single digit yields. Aid-dependent governments are experts at managing donors, but they are novices when it comes to tapping markets and negotiating with armies of savvy investment bankers. The UK is well-endowed with professionals capable of providing target TA to governments making their first foray into the global markets.

Donors should also give high priority to establishing local savings institutions in frontier economies, especially pension funds. Pension systems are the backbone of the financial infrastructure. Government yield curves, market-making, and repo markets all follow in the wake of pension funds. And once government yield curves exist the door opens for term funding for corporates. Pension funds also have a highly stabilizing effect on the macroeconomy.

Corporate market development must follow a specific sequence. Low income countries should open up their domestic local currency markets to foreign investors broadly in line with the expansion of their domestic pension systems so as to avoid excessive FX and yield curve volatility during the early stages when foreign portfolio flows can be overwhelming. Pending the emergence of depth in local markets, donors should promote the development of hard currency yield curves. A number of frontier economies have recently issued bonds successfully, including Ghana, Gabon, Senegal, Nigeria, Republic of Congo, Namibia, and Sri Lanka. Others are on the way. Hard currency sovereign yield curves are internationally comparable and provide instant feedback to policy makers about their performance, feedback which is both complementary and preferable to quarterly visits from IMF officials.

At a time of strong global anti-market sentiment, it is essential that donors also ensure that legislative and regulatory clampdowns do not adversely impact financial development. Donor agencies have traditionally been lukewarm supporters of financial market development. In some cases, donors outright impede efforts to come to market. For example, the IMF still assumes zero return on public investment in poor countries, thus precluding non-concessional financing by design. Yet, returns from activities like road maintenance and other basic infrastructure are much higher than zero. Also, well-meaning but seriously misguided pieces of legislation, such as the recently approved UK legislation against Vulture Funds strongly discourages capital market development by driving up risk premia and reducing secondary market liquidity specifically for HIPC countries. EMTA, the emerging market traders association, has written at length on the unintended negative consequences of this legislation.

Private sector-led job creation is the only sustainable way to eradicate poverty in poor countries, but private sector growth requires good governance. Aid programs should specifically target second-tier governance issues and bottlenecks, which retard the private sector. One of the biggest bottlenecks is physical infrastructure. Infrastructure provision should, as far as possible, be transferred to the private sector. Governments are hopeless at managing projects. When projects have clear public good characteristics, they should still be undertaken by the private sector, but with subsidies to cover the public good elements explicitly provided in national budgets. The development of pledge-able legal titles for property is an easy win: title enables property to be transferred, so, for example, homeowners can borrow against the security of their homes to start new businesses. Efforts should also target improvement of courts to enable better private sector dispute resolution and upholding contracts. Donors should help to reinforce the integrity of borders and private property, supporting army and police, even stand ready to send troops to protect hard-won democratic institutions from abuse. There should be zero tolerance about corruption. Aid should not be used as trade policy, because this benefits specific companies in donor countries more than aid recipients. Trade is different from aid and should be promoted as much as possible.

Which countries should have less aid?

It is generally true that 'big aid' has never worked other than in very specific circumstances and over short periods of time, such as recovery from crisis. 'Big aid' recipients need to be weaned off aid as soon as possible, but responsibly. Many big aid recipients are very poor, fragile, and shock prone, so cold turkey is not an option. Smart aid actively phases in private alternatives without disrupting the positive growth dynamics now in evidence in many frontier economies.

The key to identifying which countries should receive less aid is to identify criteria giving aid and for withdrawing aid. This is ultimately a political judgement, which should be informed by an accurate assessment of the economic and political reality at the present time. Here are some basic criteria where and how aid should be cut:

• Given the critical importance of maintaining healthy macroeconomic conditions, aid should be cut to countries, where aid flows constitute the sole source of external financing, and where the scale of inflows causes macroeconomic distortions such as Dutch Disease. There is nothing more damaging to the fledgling private enterprise than real exchange rate overvaluation.

• The entire Cold War experience shows aid is useless and development efforts ultimately futile, when people are denied fundamental democratic rights. Aid to such countries should be curtailed immediately.

• Aid volumes should not be set in stone, but should be informed by the specific opportunities available to employ aid effectively and productively. This means that aid should also be scaled back where it creates serious microeconomic distortions. For example, there is too little recognition in donor circles of the risk involved in private entrepreneurship and that excessive salaries in aid projects rob the private sector of important talent. Countries where aid is lost to corruption or wasteful spending should see their allocations cut immediately. Incentives matter - donors should set up systems to penalize donor agency officials responsible for bad aid. And incentives should be in place to encourage local civil servants to save money.

• Aid is charity. Charity is ultimately a moral choice, though altruism can also benefit the giver. Donors should neither ignore nor seek to alter the social norms in the recipient country. Different cultures have different preferences for income equality versus economic freedom, gender roles, religious values, and how to design democratic accountability. If a donor profoundly disagrees with local values it should not give aid. On the other hand, if it does decide to give aid then it should respect the local values of the recipient country. Aid should not be given to countries as a means of extending trade protection to the donor's domestic businesses. Aid for trade is really aid for businesses in donor countries, not, as it should be, charity.

Clear aid criteria should be applied to all countries in receipt of official ODA. It is down to an empirical analysis by civil servants to identify the specific countries, where change is necessary.

The UK aid programme

UK aid should incorporate a principle that all aid should be seen as temporary. This could be enshrined in a regular internal review of DFID flows, such that every budgeted parcel of aid is assessed to see if it has achieved its objectives. The objectives should include the creation of conditions in the recipient country that it no longer requires such aid (even if this takes years, if, for example, it means training a cadre of highly skilled people, which in turn means building universities). As a general principle, if a country has the same problems, say, three years after aid disbursement commenced to assuage the problem then, ceteris paribus, the aid should be stopped and better spent elsewhere. There will always be exceptions - but they will need to be justified.

Aid effectiveness should therefore mean achieving the best return for the money, not a given quantum return hurdle. In other words, the decision of where to disburse should not be justified narrowly on the grounds of what was done last year and worked, but through regular assessment of current alternatives. This ensures that aid progresses.

UK aid resources should be concentrated on fewer countries to target clear beneficial outcomes. This can help get better value for money and can increase the bargaining power of DFID so as to better be able to achieve the objectives.

The countries targeted for UK aid should be selected with specific reference to what the UK is good at, including governance systems, security, communications, higher education, financial markets, law, media, and institution building.

UK aid should be linked more explicitly with good political governance, in close coordination with the threat of military intervention if necessary, to ensure democratic processes and the democratic reality are upheld and, especially, dis-incentivise politicians from hanging onto power through non-democratic means.

There should be explicit recognition of the principal-agent problems associated with aid. At the country programme level for every country, is aid: a) taking up a significant portion of scarce resources, especially senior technocrats' and policy-makers' time; b) creating corruption or rent seeking or the incentives for corruption or rent seeking even if actual corruption or rent seeking is not observable or measurable; c) creating or potentially creating price distortions in the economy; d) creating macro-economic dependencies and so vulnerabilities to external shocks?

UK aid should establish the principle that not spending individual budgets or the whole budget is a good thing - not least by creating strategic reserves and cross budgeting with MoD in particular for humanitarian and governance related military interventions.

Conclusion
Frontier economies have changed. Aid needs no longer be a palliative for poor policies, or, worse, collude with forces that sustain poverty.

To be effective today, aid must be smart and very targeted at the specific constraints to growth and potential shocks, which can unsettle the healthy development process now in evidence in frontier economies.

More effective and specific aid probably also means less aid in some countries, but possibly more in others. Which countries will receive aid must be subject to a test against clear political priorities and be based on an understanding of the new reality in frontier economies. Where aid is scaled back it must be done carefully to avoid adverse macro consequences. Alternative sources of finance are available; they should be exploited now as a matter of priority.

Economists have asked for decades whether aid works. It is now clear that they got the direction of causality wrong. Aid does not work if the economy and domestic politics do not work. But if local conditions work, then aid may be effective too.

11 November 2011

Jean-Paul Azam, University of Toulouse—Written evidence

How Foreign Aid Affects Global Terrorism

1. After a period of gradual reduction in the global flow of foreign aid that reached a trough around 1997, the flows have resumed briskly and the heights of the end of the cold war period have been reached again and even overtaken at times from 2005 onwards. The geostrategic use of foreign aid was becoming clear again, as president George W. Bush declared in Monterrey in 2002: "we fight against poverty because hope is an answer to terror". The Millennium Challenge Corporation was created in the wake of this speech and led to a near doubling of the US disbursement of foreign aid. Further evidence is provided by the fact that the Obama administration has focused its foreign aid disbursements on Pakistan, Afghanistan, Iraq, beside the usual US beneficiaries in Egypt and Israel. These aid flows are quite obviously aimed at purchasing cooperation in the war on terror from the recipient governments. Within this framework, foreign aid can be viewed as the price paid by rich countries to recipient governments for them to invest resources in protecting the donors' interests within their sphere of influence, i.e., to purchase "delegated protection". Other rich countries are obviously using foreign aid with a similar purpose, especially former colonial powers who have a significant number of national firms and private individuals holding a sizable asset value invested in some of the recipient countries.

2. Some empirical analysis by Toulouse-based Jean-Paul Azam and Véronique Thelen has investigated directly this issue, with a view to test how significant is the impact of aid on the number of transnational terrorist attacks produced by countries of origin of the perpetrators. This analysis was done carefully in order to estimate the trade-off existing between foreign aid and the number of terrorist attacks, while controlling for reverse causation. If such a trade off really existed, it would be arrogant to assume that only econometricians are aware of it, and not policy makers. Hence, two questions have to be analysed jointly, namely (i) is there a trade off between foreign aid and the supply of terrorist attacks? and if yes, (ii) are donors actively using it? Failure to control for the possible positive answer to question (ii) would bias the findings regarding question (i) and result in spurious estimates. Applying carefully this method, Azam and Thelen (2008) have provided a positive answer to both questions. Foreign aid is thus used effectively by donors to reduce the number of terrorist attacks emanating from recipient countries, and is thus contributing significantly to improve global security.

3. However, some rich countries also use military intervention in foreign countries, and often claim that this is done with a view to counter terrorism. The US-led intervention in Iraq was presented to the media and the world's public opinions explicitly as an important part of the global war on terror. Some dissenting voices have been heard from social scientists and other observers questioning whether this was a truthful argument, suggesting that oil-related interests were probably playing a much more decisive part in motivating the military intervention in Iraq. These people were sometimes adding a warning that such interventions might in fact backfire and trigger instead some increase in the number of terrorist attacks from these countries and their neighbours. Social scientists from different sub disciplines have provided evidence that terrorist attacks respond to a clear political agenda, and Chicago professor Robert Pape in particular has emphasized the nationalistic motivations of terrorist attacks, especially in Middle Eastern countries. Then, the presence of

foreign soldiers in the Middle East was shown to be a major cause of terrorist activity, aimed in particular at ousting foreign soldiers from the Arabian Peninsula and other Middle Eastern countries. This was in particular a cue used explicitly by Al Qaeda, but it was also present in the discourse of Hezbollah in Southern Lebanon, among others.

4. Azam and Thelen have also investigated this issue empirically in another published paper. Like in the case of foreign aid, one has to take into account the possibility of the foreign power to really use the military intervention in order to abate terrorism when looking for a trade off between the two phenomena. Moreover, the empirical relationship might also be affected by some other motivations for the military intervention and in particular by oil-related matters, and this should be analysed jointly with the impact of foreign aid. Azam and Thelen (2010) have taken this possible mix of motivations behind military intervention into account by controlling for the heterogeneity of the geo-strategic values of different countries from the North's point of view. Their findings suggest that the distance to oil of the host country matters significantly. When the intervention occurs in a country that is far enough from oil wells, then there is some significant evidence that military interventions are effective against terrorism, and are actively used for this. However, they find some convincing evidence that military interventions in oil-producing regions do backfire by triggering an increase in the number of terrorist attacks perpetrated by citizens from the host countries and their neighbors. These tests were performed alongside those regarding the impact of foreign aid, which remain significant and robust. Hence, while foreign aid is still found to reduce the number of terrorist attacks originating from recipient countries, the findings regarding military interventions are ambiguous, depending on whether the host country is an oil exporter or not.

5. A complication arises because foreign aid and military intervention may influence the number of terrorist attacks in various different ways. The findings briefly presented above relate to the number of attacks produced by nationals from recipient countries against foreign interests, whether these attacks take place at home or in a third country. However, foreign aid and military interventions have been found by Azam and Thelen (forthcoming) to have some additional effects. The issue is related to the fluidity of transnational terrorism that sees activists travelling easily across some borders and perpetrate their attacks in various foreign countries, sometimes far away from their source countries. This raises an incentive problem for recipient governments, as their successful efforts to reduce the number of terrorist attacks perpetrated by their militant nationals might be hidden partly by an increase in the number of attacks imported from other countries and perpetrated on their territory. Terrorist organisations are choosing the countries hosting their attacks on the basis of these countries' attractiveness for them. Foreign presence and reduced home-grown terrorist activity are bound to enhance a country's attractiveness as a host for terrorist attacks. Moreover, the benefits of a government's effort at reducing terrorist activity from its own country might spill over abroad, as the affected terrorist organization might in fact contract their activity level abroad as well as at home. Azam and Thelen (forthcoming) have tested econometrically these effects. While their findings confirm that foreign aid is robustly reducing the number of terrorist attacks originating from recipient countries and that military interventions tend to increase the number of terrorist attacks originating from oil-producing regions, they also show that both foreign aid and military intervention increase the host country's attractiveness for terrorists.

6. To sum up, foreign aid has a globally favourable impact on the production of terrorist attacks originating from recipient countries while military interventions have a counter-

productive effect when they take place in oil-exporting regions. However, some serious incentive problems are created for recipient governments by the fluidity of terrorist activity across borders. Global efficiency against terrorism thus requires the donors' community to coordinate its aid allocation across recipient countries with a view to take into account all the implied spill-over effects and to compensate the governments of the affected countries accordingly. Some powerful modelling is certainly needed to track these spill-over effects accurately and to optimize the allocation of foreign aid across the source-countries of potential terrorist attacks. Lastly, the claims made by many critics of military interventions as a trigger for increased terrorist activity against rich countries have been vindicated by the careful econometric analyses briefly described above. This suggests that (i) military intervention in oil-producing regions should be used sparingly, if countering terrorism is regarded as a worthwhile objective, and (ii) when they remain on the agenda for some other political reasons, then they should be accompanied by an increase in foreign aid, not only in the intervention-hosting countries, as done by the Obama administration, but in some other ones that may suffer from spill-over effects as described above. This remark is probably highly relevant in relation to the current stalemate affecting the NATO intervention in Libya, and European countries should get prepared for a wave of terrorist attacks, unless some additional effort regarding foreign aid is performed in favour of some key countries.

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30 June 2011

Embassy of Bangladesh—Written evidence

(Economic Relations Division [Section Europe 1], Ministry of Finance, People's Republic of Bangladesh)

Statement on Economic Impact and Effectiveness of Development Aid

How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, what has been the impact of British ODA? How robust are results from studies in this area?

1. UK government's *Official Development Aid (ODA)* coming through DFID is being utilized in the form of investment and technical assistance projects undertaken by the Government of Bangladesh. Major part of this aid is given as grant and both the parties have active involvement in the project activities. The identified target groups or beneficiaries of these projects are directly dealt with through the project activities. The project activities, mostly aimed at poverty reduction and economic development, has diverse impacts. There are projects like the *Chars Livelihoods Programme, Development Business Service Markets, Remittance & Payments partnership Project, Economic Empowerment of the Poorest, Tax Administration Capacity and Taxpayer Services Project* those dealing directly with poverty reduction, economic growth and nurturing the playing field for economic activities. These projects continuously uplift the standards of lives of the target groups as well as preparing the surrounding for economic betterment. Though the number of beneficiaries are not very significant compared to the huge population of rural Bangladesh, the impact on this small group is noteworthy. There are also technical assistance programmes like the *English in Action* project, which aims at building the base of English language proficiency among mass people that they require for competing within the *ready for action* world of opportunities.

What factors determine the effectiveness of ODA in recipient countries? Are they dependent on the scale and form of aid flows? How is aid effectiveness monitored?

2. The most important aspects in making ODA effective are identification of actual needs of specific country, their prioritization according to their spread of impact and their credentials of sustainability. Aid effectiveness also depends on the scale and forms of aid flow. For example, impact/ outputs of some projects cannot be predicted beforehand and if a small-scale investment brings significant value for money, they automatically urge for another phase and additional financing. There are projects that cannot be handed over to the beneficiary community without prior preparation on their side. For projects of this nature, there should a mix of forms of assistance, i.e. investment and technical ODA.

3. Sustainability and long term impacts of ODA undertakings are monitored but not a very persuasive level.

Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA? What has been the British government's experience?

4. In developing countries, imposition of conditions by donors sometimes ensures proper utilization of the ODA. On the other hand, there are provisions, which lessen the scope of employment of local resources and expertise. It is also noticed that though the agreement is signed with the recipient Government, the concerned ministry has minimal involvement and ownership over the project activities. This nominal role of the ministry is coupled with no or less incentives that result in less commitment on their side. Aid conditionalities in such setting are not desirable for the recipient countries.

How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?

A need based allocation designed by experts of respective fields and addressing immediate threats would ensure the use of UN target of developed countries giving 0.7% of their GNP in ODA. It is not like that there is no need of additional aid or additional aid can wipe out a problem for good; rather, there are ever existing problems like environmental degradation and so on. If a situation arises when targets are reached, there is always an option for changing aid policies.

Does ODA complement or inhibit private investment in developing countries?

Given the scenario in Bangladesh, ODA definitely complements private investment. The Government of Bangladesh has the policy and practice of *Public-Private-Partnership,* which is a platform for working together for GoB and private sector. Most of the Government initiatives in co-operation with development partners are related to infrastructure development, education and skills development at mass level, capacity building for government officials etc. These kinds of developments create and nurture the environment for investment and business for private sector investors and there is hardly any chance for duplication of activities.

How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

The roots of current trend of security concerns are economic and social exclusion, internal and bilateral instability, lack of proper understanding and tolerance. Economic growth and social safety deals with this problem partially. In addition, there should be initiatives to address this from an intellectual viewpoint by taking on initiatives to deal with broader public mindset/ misconceptions, issues of co-existence and tolerance and dialogue/ discussion.

In what ways, if any, can the British government improve the effectiveness of its development aid?

- Using local expertise to identify, design and manage development projects
- Secondary analysis of works already available in host country before doing baseline study and design of any project
- Increase involvement and ownership of Government of Bangladesh/ concerned ministry in every phase of projects

30 June 2011

Name of the Author: Sayeda Akther
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Aid Effectiveness Unit of Economic Relations Division, Bangladesh—Written evidence

1. Following your Call for Evidence, We now enclose our thoughts on this matter and provide answers to the questions that you ask as follows:

1. How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, what has been the impact of British ODA? How robust are results from studies in this area?
Poverty reduction has always been the major development challenge for Bangladesh. It was and still is the overarching objective of the government since independence in 1971. Sustained economic growth since the early 1990s has allowed the country to make good progress in poverty reduction and gains in Human Development Index despite a series of domestic and external setbacks. During the past decade of 2000-01 to 2009-10 Bangladesh has achieved an average GDP growth rate of 5.83 percent per year with GDP per capita reaching US$ 685 in 2010. Revenue reforms led to increased revenue/GDP ratio from 9.6 in 2000-01 to 11.0 in 2009-10. The expenditure/GDP ratio has also increased significantly during this period and remained 14.5 percent in 2009-10. The poverty incidence declined from 58.8 percent in 1992-92 to 40 percent in 2005, while extreme poverty rate declined from 41 to 25 percent over the same period. The estimated poverty rate, in 2010-11 is expected to have come down between 30-32 percent. An estimated 56 million people are still living in poverty, of which 35 million are considered to be extreme poor. Moreover, disparities in poverty across different occupational groups, gender and regions are persisting, if not growing. Bangladesh is also one of the countries most vulnerable to the negative impacts of global climate change, with an increasing population and a shrinking land surface. The country has always been a major recipient of Official Development Assistance (ODA) and effective management of aid, for that matter, is one of the serious concerns for the Government of Bangladesh (GoB). DFID work towards goals in wealth creation, health, education, water and sanitation, poverty, hunger and vulnerability, climate change (including disaster preparedness), and governance and security in Bangladesh. DFID's 2011-2015 portfolio will build on tried and tested approaches, whilst allowing for innovation and learning within programmes. DFID maintain a diverse spread of projects which will balance direct support for poor people in the short term with building national and regional government capacity and stimulating economic growth over the medium to long term. All the work will focus on results, using evidence of impact and value for money. Delivery partners will share the responsibility for demonstrating that UK taxpayers' money has been effectively used to achieve real change for Bangladesh. The UK's new commitments on transparency are uphold, by funding and driving forward: ▪ A new Aid Information Management System, which will help the Government of Bangladesh to collate, analyse and share data on donors' projects; ▪ Public financial management reforms that facilitate transparency on budgetary information across the Government of Bangladesh; ▪ Work by Transparency International Bangladesh and other civil society actors to facilitate

dialogue between the Government of Bangladesh and citizens on transparency and accountability in service delivery (including health, education, legal services);

- An e-registry of all the international treaties, laws and regulations affecting businesses in Bangladesh.

2. How does economic growth in countries which experience large surges in ODA compare to similar countries which do not?

The implications of these issues are – among others – clearly visible in low the utilization rate of development resources, foreign and domestic. On average, only 60% of the original Annual Development Programme (ADP) is utilized. This often results in inefficiencies and increases the risk that funds are not used for their originally foreseen purpose. Delays resulting from overly complex procedures are among the main causes of this expenditure pattern. Slow preparation, approval and implementation of projects also widens the gap between commitments and disbursements, which does not only affect individual projects, but ultimately the growth rate of the entire economy. It is estimated that Bangladesh needs an economic growth rate of 9% on average over the coming years, in order to reach its target of becoming a middle-income country by 2021. The average growth rate over the last years was roughly 6%. Hence, Bangladesh depends on further investments to boost its economic growth and foreign assistance plays an important role in this regard, given that it accounts for almost 50% of the development budget. However, existing Government procedures for planning, programming and budgeting may actually reduce disbursements and mitigate the effective utilization of external resources. Major donors, such as the World Bank, indicate that their disbursement ratio in Bangladesh is comparatively low, which – according to their analysis – is partially due to project approval and review procedures that contribute to significant delays and affect the timely release of allocated funds. Hence, the Government of Bangladesh is currently not accessing all committed resources within the planned release schedule and cannot even fully utilize all disbursed resources. Delays in aid disbursements and project implementation are, of course, not only caused by Government procedures and capacity constraints of executing agencies. In many cases, donor conditionalities and complex development partner procedures are also contributing to delays and missed opportunities. However, there is sufficient evidence supporting the conclusion that the existing aid management procedures should be rationalized to increase aid inflows and improve the efficient and effective utilization of development resources. Consequently, GoB should expand its current approach to improving aid effectiveness, which seems to be primarily focused on policy level dialogue and activities geared towards local implementation of the global aid effectiveness agenda, Implementation of Aid Information Management System (AIMS) and Preparation of Aid Policy in Bangladesh.

3. What lessons, if any, can be learnt from the experience of former aid-receiving countries that have graduated from reliance on ODA?

Governments tend to express a preference for budget support, which is considered to increase national ownership and strengthen national institutional capacity; reduce transaction costs; improve coordination; and make ODA disbursement and delivery more flexible. However, it should be kept in mind that to be effective budget support requires some basic conditions to be in place. Benefits from providing aid through budget support are therefore likely to materialize only in the medium term to longer term. Budget support has proven to be a highly volatile aid modality. In principle, budget support should enable donors to provide governments with greater certainty about funding flows over the medium term. This, in turn, gives governments the assurance needed to plan service delivery improvements. However, the fact that budget support is both high-profile aid and highly flexible from the donor's perspective makes it more of a challenge to deliver predictability. There is evidence that, in the short term, aid has become less predictable. Given that donors consider budget support as a more risky and less visible aid modality, they often request more 'policy dialogue' and information during aid negotiations and closer monitoring during implementation. The effectiveness of budget support largely depends on the amount and type of conditionalities attached and the way they are managed by donors, as well as on the capacities of government institutions, including those responsible for implementing an aid funded activity. Project-based assistance has the advantage that it (mostly) delivers clear results, including in areas where local capacity is limited. Many of the negative effects of projects that work outside of the regular government system could be addressed through clear regulations regarding approval and reporting requirements. Hence, governments should recognize the value of other aid modalities, such as project-based assistance, as a means of introducing new approaches and technologies, as well as fast tracking service delivery in areas of limited national capacity.

4. What factors determine the effectiveness of ODA in recipient countries? Are they dependent on the scale and form of aid flows? How is aid effectiveness monitored?

Aid coordination architecture was informed by international good practices and lessons learned from other low income countries. While it is critical to avoid any 'one-size-fits-all' solution, the following elements have generally proven to be conducive to effective, government-led aid coordination and management: (1) a prioritized national development plan; (2) clear institutional arrangements for planning, programming and budgeting of resources – foreign and domestic; (3) collective dialogue and coordination mechanisms; (4) an aid information management system; (5) a statement of aid policy.

A crucial precondition for enabling the Government of Bangladesh to coordinate development partners and manage aid flows effectively is the availability of accurate and timely aid data, as well as the ability of government staff to analyze the data, as well as package and present it in a way that allows informing and influencing decision-making. At the moment, there is a lack of comprehensive and timely data to inform decision-making, as well as evidence-based dialogue with development partners. The lack of comprehensive aid data also prevents a more evidence-based dialogue among development partners on a rationalization of sector support. Comprehensive aid data that is accessible to various Government institutions, including line ministries, and development partners would inform discussions within LCG Working Groups, which could play a crucial role in tracking aid flows against the background of joint results frameworks. Against this background, it is recommended that an aid information management system that allows tracking and recording of all foreign assistance (grant and loans; financial and in-kind) be established.

OECD-DAC Survey and Paris Declaration Evaluation are the great opportunity to highlight the reality of Bangladesh in terms of the implementation of Paris Declaration and the Accra Agenda for Action (AAA). Government and DPs are positively contributing the process by providing valuable inputs into the survey and evaluation process. The most important thing is to reflect the ground reality in the country context. The report analyse the indicators in Bangladesh context, and review the changes at both GoB and DP level, which help us to better understand what works and what does not and why.

5. Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA? What has been the British government's experience?
Imposing condition on the project or program aid and that for policy reform restricts the capacity and/or sovereignty of the country; Bangladesh receives large amount of its aid in this form. Most often conditions imposed might not match the spatial and institutional aspects. Past experience shows that the primary objective of the GoB is to conclude the loan agreement and that they are quite willing to make a large variety of paper commitments to the DPs to conclude the loan agreement. These commitments do not always take account of the actual capacity or institutional weakness of the executing agencies to implement these reforms. All these undermine the importance of aid to the country, affects aid effectiveness as it leads to increased aid fatigue. Generally putting boundaries on the aid offered either on the process of aid allocation or implementation criteria or managing projects by expatriates increases the transaction cost of the aid (reduces aid effectiveness as greater portion of the money is used by the donors), undermines the technical capacity of the country; and retards domestic participation in development processes. It has been recognized that these criteria led to increase the total cost of the project than the expected benefits. UK does not have conditionality attached to its bilateral programme.
6. How should ODA be allocated? How far do (and should) the Millennium Development Goals (MDGs) shape aid allocations?
The ODA inflow to the least developing countries is warning. Bangladesh in the recent past years, received foreign assistance amounting on average to US$1.54 billion per year, much less than its requirement to pursue her development targets in achieving MDGs. One disconcerting feature of ODA has been the persistent gap between commitments and disburesements. Hence, the debt servicing outlay for total public debt during FY 2001-07 rose to 1.8% of GDP during the 1980's and consequently reduced available fiscal space to finance the MDGs and other development programmes. The UK is focusing much of its support to LDCs, including doubling of support to Bangladesh – UK development support is focused on reducing poverty (to achieve MDGs and ideally go beyond just MDG targets in some areas).
7. How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?
Although developed countries committed themselves to make available 0.7% of their gross national income (GNI) to developing countries for development purposes, the current figures stand at only 0.3% (OECD/DAC 2006). Such a significant increase in resources would have a significant impact on poverty reduction. Absorption would be a challenge but is not insurmountable. There are many channels for managing such support in Bangladesh including public-private partnerships, or direct delivery by NGOs, as well as directly through Government systems. Therefore, both donor and recipient countries should endeavour to build consensus around the principles of the Paris Declaration on aid effectiveness, and to increase the volume of aid that can be used for tackling poverty and achieving development goals of recipient countries.
8. Does ODA complement or inhibit private investment in developing countries?

In Bangladesh, a vibrant private sector and a large pool of inexpensive labour contributed significantly towards the continuation of a robust growth during the past decade and showing sign of sustainability. The increasing role of private sector in maintaining macroeconomic stability should be underpinned in the appropriate perspective. This sector can also be shaped up as a channel of providing aid to ensure improvement in the delivery of public good as is being considered by the Government in its vision for Public Private Partnership. However, market mechanisms can never fully meet the needs of the poorest. ODA plays a key role in providing basic services, social protection, disaster management and meeting the needs of the poorest. It is also used to catalyse further investment from the private sector.
9. How does ODA, and British aid in particular, interact with financial flows from other sources including new donors, such as China, India and Brazil, private capital flows, and philanthropic sources?
South-South knowledge exchange is grounded on horizontal partnerships, based on equity, trust, mutual benefit and long-term relations traditional donors as triangular partners. The horizontal character of South-South and triangular partnerships is a key contribution to the evolving global development agenda. British aid is yet to align with the South-South Cooperation. They may support the design of country-led capacity development plans, generate multilateral and donor support for the implementation of these plans, giving a role of Southern academia in training and institutional/operational learning, country coordination through existing platforms at country and regional levels.
10. How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?
No comments
11. What are the prospects for using aid to support market-based initiatives, for example in providing insurance against earthquake damage?
Despite our inadequate availability of resources and vulnerability to frequent natural disasters including adverse effects of recent climate change, Bangladesh made reasonably satisfactory progress compared to many other aid recipient countries in reducing poverty, accelerating the pace of socio economic development and responding to the immediate impact of disasters. A multidisciplinary approach to adaptation and risk reduction programmes is therefore recommended. Insurance schemes are one such approach that is being considered, though there is not yet a national policy.
12. In what ways, if any, can the British government improve the effectiveness of its development aid?
Since April 2009, DFID has supported to the multi-donor fund on aid effectiveness which supports the development and implementation of the JCS action plan. This technical and financial assistance was designed to help the GoB and Development Partners to improve dialogue and streamline aid management processes. It includes specific support to the JCS process, the Bangladesh Development Forum, the Aid Management Review, the Paris Declaration Evaluation etc.

A project on Strengthening Capacity for Aid Effectiveness in Bangladesh has been planned for implementation by both Government and Development Partners. The project will pave the way to a more efficient and result-oriented use of foreign assistance in the country. DFID is contributing in the project as part of multi donor initiative. More to do for the improvement of the effectiveness at the policy level, program level and project level of development aids in Bangladesh. The role UK played as DP Co-Chair of the LCG Executive Committee throughout last year in driving the JCS process and supporting the Bangladesh Development Forum (BDF) gives a new mommentum on aid effectiveness in Bangladesh.

Rafique Ahmed Siddique
Monowar Ahmed

30 June 2011

Mr Matt Berkley—Written evidence

Time to end the myth of official poverty measurement?

1. Summary and possibilities

1.1 This document relates to the aims of aid, and the provision of technical aid from macroeconomists. It explains how macroeconomic evidence on poverty, and the effects of officially reported economic activity, policies or aid on it, may be different from what the Committee believes.

Problem 1: Defective reasoning in influential studies. The UK promotes studies inferring relative economic benefit to the poor from officially reported economic activity, trade, policies or aid, based on spending data. The studies use methods clearly far inferior to those of Rowntree in the UK's past. They omitted necessary inferential steps, including: estimates of **data reliability**; price **inflation** for the poor; **needs** assessment; **asset** levels; **debt** levels; and the influence of **demographic change** on the cross-sectional statistics. We cannot know what people received or consumed, or other aspects of their economic welfare, from these numbers. The UK fails to note the problems.

Complacency may be further eroded by two facts:
a) The financial crisis in rich countries showed inferences from economic activity to wealth creation to be irresponsible. Those inferences led economists to overlook the fact that a large proportion of spending was funded by rising debt, not rising wealth.
b) MDG indicators for *consumption poverty* strangely report better progress than other indicators, including for *hunger*.

Problem 2: Defective reasoning in aims. Is trying to increase spending by the poor sensible?

Problem 3: Narrow selection of views. The UK repetitively cites the same World Bank author.

Problem 4: Outdated figures. The UK has been citing research from before food price rises.

Problem 5: Impossible statements. The UK has made claims for which there are not even spending data, thus exaggerating the recency of studies and reported progress.

1.2 Possible solutions: The Committee may wish to consider whether it finds these practices acceptable, morally or otherwise. If members feel unable to endorse the Government's methods as suitable if they were poor themselves, they are invited to consider two options: **referring the matter to one or more Parliamentary Committees with an appropriate remit, possibly while remaining the lead Committee,** or **recommending** that the Government and organisations it funds:

i) refrain from publicising unsupported inferences from spending to gain;
ii) publish revisions to those inferences and to claims based on outdated or no data;

iii) revise policies and priorities lacking sufficient alternative arguments;
iv) only pay for social science staff who can explain, and demonstrate, exactly what their methods do and do not tell us about real events for real people.

2 Introduction

2.1 Matt Berkley lived in Bangladesh in the 1980s for sixteen months to find out more about the causes of poverty. He lived for several months with four members of a farming family in a one-room village house. In 2000 he noticed, and began notifying senior academics and officials of, a flaw in economic theory: inferring aggregate outcomes without counting how many survived. A suggestion that survival be taken into account was subsequently adopted by academics. In 2003 he notified the Chairman of the Commons Select Committee on International Development of several errors in large studies claiming to look at global poverty. Among the flaws were that the largest macroeconomic policy studies had omitted to look at relevant inflation rates for the poor, and that global poverty claims omitted rising costs due to rising proportions of adults. He is not sure whether any tendency to see things from the point of view of the subjects of research stems from temperament, attempts at imagination, or experience. He has degrees in classics and experimental psychology.

2.2 This document follows consultation with professors of economics, political science and philosophy at the London School of Economics, Cambridge, Princeton, Columbia, Cornell, Texas, Harvard, Oxford and other universities; officials in DFID; and officials responsible for Millennium Goal monitoring and reporting for the UN Statistics Division, World Bank and FAO.

2.3 This document relates to the Committee's questions on: how far MDGs should shape allocations; what factors determine the effectiveness of aid; how aid effectiveness is monitored; how might the UK improve the effectiveness of its development aid.

2.4 The "should" questions might reasonably be taken as referring to a moral aspect, or an overarching question: <u>What would Committee members want as the basis for policy decisions about themselves, if they were poor?</u>

3 The 2002 Act authorises action likely to benefit people.

3.1 The International Development Act is not concerned with increasing the flow of money round the system. Economic growth, income and expenditure are measures of the flow of money, not wealth creation. They are not measures of consumption adequacy. (The argument that growth funds tax revenue is separate.) How can the Secretary of State judge from economic statistics on spending what is likely to help the poor, without assessment of whether price, needs, assets and debts are favourable?

4 Why are economic MDG indicators statistical outliers?

4.1 According to official statements, progress as been good on *extreme consumption poverty*, and bad on *hunger.* [11] How can we explain that? [12]

[11] UN MDG Report 2011. http://www.un.org/millenniumgoals/pdf/(2011_E)%20MDG%20Report%202011_Book%20LR.pdf
[12] "Hunger is a direct consequence of poverty. Poor households spend the large majority of their disposable income on food or depend on food they grow themselves."
http://www.dfid.gov.uk/Global-Issues/Emerging-policy/Wealth-creation-private-sector/?tab=2

4.2 A similar puzzle exists in relation to other needs. If consumption adequacy has been improving at such a satisfactory rate, why have other indicators not been on track? [13, 14]

5 Is the Committee happy with the aim of reducing the proportion of low spenders?

5.1 "Aid effectiveness is about achieving the most poverty reduction possible for each pound or dollar of aid spent." (DFID, 2008) [15]

5.2 "Every year, your taxes help 3 million people lift themselves out of grinding poverty around the world." (DFID, 2010) [16]

Comment: How can DFID know that from the available data? DFID do not have estimates for poor people's prices; needs for food or medicine or rent; asset levels; or debt levels; and have not excluded effects of demographic change on the cross-sectional statistics. A person for whom costs rise faster than income would other things being equal be worse off, not better. DFID cannot know either what people got for their money, or whether consumption adequacy improved. They do not know what these statistics mean for real people.

5.3 Some factors influencing your and others' economic welfare:

Assets	Debts	Income
Needs	Prices	Shared assets
Shared debts	Environmental benefits	Environmental costs

5.4 Adam Smith talked about needs, and the inflation rate for the working classes (the “real recompence of labour”). Is the Committee happy about economists and the UK Government saying they can measure poverty and recommend policies without looking at either?

[13] The surveys are described as including the imputed value of own produce consumed. A similar problem applies here as in the case of transactions.
[14] While the World Bank has issued some statements about impact of national food price rises on poverty in recent years, data for poor people's food prices were not compiled for any year.
[15] Memorandum submitted by the DFID on behalf of the UK Government. Co-Ordination For Aid Effectiveness Inquiry. House of Commons International Development Select Committee. Written Evidence, 2008. http://www.publications.parliament.uk/pa/cm200708/cmselect/cmintdev/520/520we02.htm
[16] http://www.dfid.gov.uk/Media-Room/Features/2010/Why-we-give-aid-to-developing-countries/

6 Macroeconomic "poverty reduction" is 80% woolly

Statements presented by the Treasury [17], DFID , BIS, and ESRC [18] **on**	
a global trend ("500 million people rose out of poverty" [19] or "your taxes help lift 3 million a year" [20])	**what benefits the poor** ("growth accounts for 80 percent") [21]
are based on **data** [22] of **unknown reliability** [23, 24]	

[17] "...more than 80 per cent of poverty reduction is accounted for by long term growth in average incomes." No evidence supplied. HM Treasury, 2010. Spending Review. Cm 7942. http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf.

[18] "A programme of research on economic growth is being commissioned for several reasons. Firstly, a growing body of empirical work highlights the importance of economic growth for poverty reduction, with important implications for progress towards the Millennium Development Goals (MDGs)... Kraay (2006) concludes that growth in average incomes accounts for approximately 80% of absolute poverty reduction in the long-run." DFID/ESRC 2011. Growth Programme Specification of call for applications. http://www.esrc.ac.uk/_images/DFID_growth_spec_tcm8-15017.pdf

[19] These claims usually come from Chen, S., Ravallion, M., 2009, "The developing world is poorer than we thought, but no less successful in the fight against poverty". Working Paper 4703. Chen and Ravallion devised and monitor MDG1 economic indicators.
http://www.wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2010/01/21/000158349_20100121133109/Rendered/PDF/WPS4703.pdf

[20] "How do we calculate we lift three million out of poverty every year?...Economic evidence about the effect of aid on growth and of growth on poverty means we can estimate the number of people in each country that DFID pulls out of poverty....These estimates are based on the Collier and Dollar poverty models which have been influential in allocation decisions of other bilateral and multilateral organisations...." Supplementary memorandum submitted by the Department for International Development, Letter from Shahid Malik MP, Parliamentary Under-Secretary of State, 2008. House of Commons International Development Committee. Written Evidence.
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmintdev/520/520we03.htm
It will not surprise Committee members that Collier and Dollar did not use information on poor people's prices, or needs, or assets, or debts, or data reliability, or demographic change.

[21] See also http://www.theigc.org/partner/department-international-development : "It is estimated that over the last 18 years, growth has lifted 500 million people out of poverty (accounting for 80% of poverty reduction)" . The International Growth Centre is funded by DFID and based at the LSE and Oxford. The 18-year period appears to be a mistake, as is the 15 years mentioned by BIS and DFID (above).

[22] The surveys are on consumption expenditure plus own produce consumed, and where those are unavailable, the surveys are on income. Chen and Ravallion state, "*When there is a choice we use consumption in preference to income*". (2009, as above).

[23] James Galbraith of Texas (emails to this author, 2003) has characterised it as unreliable. Anthony Atkinson of Oxford and Brandolini of the Bank of Italy said "...we are not convinced that at present it is possible to use secondary data-sets safely without some knowledge of the underlying sources; and **we caution strongly against mechanical use of such data-sets**." (2000). http://economics.ouls.ox.ac.uk/12713/1/tema_379_00.pdf

[24] The World Bank's own evaluator, Daron Acemoglu, wrote of the Dollar and Kraay paper on growth and poverty: "Cross-country inequality data are **computed in a very suspect manner, and I find them generally unreliable**", as well as "the regression methodology... may bias the results toward finding the conclusions that the authors do find." http://siteresources.worldbank.org/DEC/Resources/84797-1109362238001/726454-1164121166494/3182920-1164133928090/Daron-Acemoglu.pdf

<table>
<tr><td colspan="4">adjusted by
inflation rates of no known relevance to the poor [25, 26, 27]
with
no assessment of need [28, 29]
and
no assessment of changes in assets or debts [30]
and taking
no account of possible confounding influence of demographic change

- perhaps unwise in general, and especially in view of, for example:</td></tr>
<tr><td>**Urbanisation** [31]

(may plausibly increase need for rent and transport fares; may be associated with lower land ownership so less security)</td><td>**Sharp food price rises since 2005** [32]

(So analyses outdated. Why are DFID still citing World Bank figures from 2005?)</td><td>**Rise in food needs per person** [33]

(due to rapid falls in birth rates, including China 1-child policy)</td><td>**Concerns about charges for water, sanitation, electricity, education, health care**

Is all spending a sign of added prosperity?</td></tr>
</table>

6.1 The problem is not just that statements on progress or the relationship between growth and poverty are untrustworthy. **The same problems apply to all other conclusions by economists from these methods** as to success or otherwise of countries, economic conditions (such as trade levels), or policies. The distribution of

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25 "Price indexes are weighted averages of prices, and **both weights and prices could be wrong.**"
Deaton, A. and Dupriez, O. [Princeton and World Bank respectively] 2009. Purchasing power parity exchange rates for the global poor. These two authors looked at reweighting the 2005 prices for the purchasing patterns of people at the poverty line, but not people below it and not for previous years, and not for prices that poor people paid for those goods or services.
http://www.princeton.edu/~deaton/downloads/Purchasing_power_parity_exchange_rates_for_global_poor_Nov11.pdf

26 Srinivasan, T.N., 2001. "Comment on 'Counting the World's Poor' by Angus Deaton", World Bank Research Observer.

27 http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/ICPEXT/0,,contentMDK:20975195~pagePK:60002244~piPK:62002388~theSitePK:270065,00.html

28 Prices x need = necessary cost. Consumption *level,* even if known via prices, would not tell us consumption *adequacy.* Many people confuse *price inflation* with the *cost of living,* ie of buying enough to meet needs.

29 Reddy and Pogge, "How not to count the poor", 2009 (www.socialanalysis.org) deals with fact that the global poverty claims fail to look at costs to the poor. The problems also apply to studies making claims, from basically the same data, about effects of policies and/or economic conditions on the poor.

30 Assets and debts are simply omitted in these claims on "poverty". This is evident from all economists' claims about consumption poverty - it is a restrictive concept. The same applies to all studies nominally of the distribution of income (in practice often spending). The poorest are not those with nothing, but those who cannot pay debts.

31 As above: the World Bank data make no assessment of changing needs due to urbanisation. Chen and Ravallion, the MDG monitors (2009, above), looked at rural-urban price differentials, which is something else. One aspect of needs is for accommodation. Chen and Ravallion say that the surveys do not generally include imputed rent of owner-occupied dwellings. That would seem to imply that people look richer if they pay rent than if they own their home, when in fact they are poorer. Since we might expect such a trend to occur with urbanisation, it would seem unwise to ignore the problem.

32 The UN MDG Report 2011 (above) still says the World Bank estimates that the target will be met. That is despite the food price rises and the fact that the World Bank has no food price data for the global poor for any year. Deaton and Dupriez (above) say that the Asian Development Bank has some mixed results on whether the poor pay different prices. Even more uncertain are past trends, and correlations with policies or economic conditions. It is not clear what reason there may be for assuming, as the UK has done, that policies or economic conditions were associated with zero price differentials for the poor relative to overall inflation. What was the effect of compound inflation differentials for the poor with growth, trade or policies? Economists do not know. So why is there talk about benefits to the poor ?

33 See "The global food error" below.

income may or may not be equivalent to the distribution of profit or of economic gains. Those relationships are contingent, not necessary.

6.2 The real risk is not general unreliability but bias. **These methods have an obvious risk of bias** against countries, times, economic conditions and/or policies where people have more security and less need to borrow because of assets; their debts are low; they save rather than spending on cigarettes or junk food; they spend less or nothing on items such as child care, rent or bus fares not because they are poorer but because they do not need them. Conversely, the risk of bias is of exaggeration of benefits in countries where people spend more, irrespective of what they got in return, irrespective of whether they needed more for food, rent or commuting, and irrespective of whether in the process they have less land or borrow money to buy food.

6.3 We might say of an observed correlation between GDP per capita growth (which includes spending) and spending per capita among low spenders, "So what?". The argument that spending or income or GDP is a reliable proxy for other aspects of welfare - which is dubious in any case as an argument from past correlations in times of social and economic changes - is dented by both the unwise assumptions that those things measured prosperity which preceded the 2008 financial collapse, and the fact that the economic MDG indicators are outliers.

6.4 Research on overall correlations does not prove that action to increase one variable will increase another. Cross-country research does not even show a correlation in the past between the variables in any particular country. So simply saying "growth causes x% of poverty reduction" would not be of obvious relevance to any particular country even if poverty had been measured, which is plainly not the case.

7 Is there transparency in the UK's evidence base?

7.1 The study repeatedly cited in recent years by UK Governments as showing the effect of growth on poverty (Kraay, 2006) [34] states, "Average income or consumption is...adjusted for cross-country differences in purchasing power parity." In reality the data on the poor are not adjusted for purchasing power parity. They cannot be, since there are no relevantly large-scale international estimates of the purchasing power of the poor's money.

7.2 Dr Kraay, like the global monitors Chen and Ravallion, said he was looking at "absolute poverty". That means physical inadequacy of resources to meet needs. But none of the researchers looked at needs.

7.3 Dr Kraay said he was looking at growth rates of incomes. He was not. Firstly, he was looking at rises in the average, not average rises. The relationship between the two depends on demographic factors (see below). Secondly, "income" is an oversimplification of what his actual data are - basically the dataset from Chen and Ravallion, who choose spending surveys (plus imputed value of own produce consumed) over income. Macroeconomists choose spending data because they are "smoother" - less volatile than incomes. That may be a defect rather than an advantage, since people may spend a) money

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[34] Kraay, A. (World Bank), 2006. When is growth pro-poor? Journal of Development Economics 80 (2006) 198– 227. Cited by BIS, DFID, DFID/ESRC, the International Growth Centre on their DFID page, and apparently the Treasury.

they are earning; b) money borrowed, or c) money from sold assets. The implications may be severe, but the macroeconomist can't tell the difference.

7.4 Any representation of the research as relevant to assessing the impact of growth on poverty during the Millennium Goal period needs to be considered in the following light:

a) Dr Kraay's latest data are for 2001 (one country) and 2000 (six countries). So the amount of data after the Millennium Goals were signed is either zero (because of lag between observation and survey compilation) or negligible.
b) It is not clear why DFID analysts think that the conclusions hold for the recent past, for the past few decades overall, or the future despite the food price rises since 2005.

The fact that UK governments have several times misstated the period over which the World Bank has reported 500 million people rising out of poverty [35, 36, 37] is odd (see above footnotes), bearing in mind the huge budget DFID has for research. The mistakes made it look as if there was good progress in a period when in reality food prices were soaring. In one 2011 paper, The Engine of Development, DFID has claimed to have figures for poverty reduction from the World Bank's World Development Indicators up to 2009, and produced a striking graph showing a steep fall, when in reality the WDI 2011 only uses figures up to 2005.

8 Has the UK ignored policies unreasonably?

8.1 A previous study by Dollar and Kraay (2000-2) [38] claimed to look at benefits to the poor from growth and, among other things, social spending by governments. It employed similar inferences: from poor people's spending to poor people's profit, and from profit to economic gain - without estimating data reliability, relevant prices, needs, assets, debts, or demographic change. Yet it was not only widely quoted, but also cited by the UK Government as an example of rigorous research. [39] Their conclusion that social spending does not disproportionately benefit the poor might be thought especially incautious when they did not exclude a likelihood of systematic bias from ignoring the factors above. Why did the authors talk of benefits they could not know?

8.2 The World Bank studies could not look at what the money actually bought. That is necessarily the case since no-one, including the global "purchasing power parity" project (the International Comparison Program hosted by the World Bank) has collated prices paid - or sometimes at least, not afforded - by the poor. [40] In fact we might say that the price of

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[35] "We know that economic growth is the most powerful instrument for reducing poverty and improving the quality of life in developing countries. Kray (2006) tells us that 80% of poverty reduction is due to growth in average incomes ....Cross-country research and country case studies provide evidence that rapid and sustained growth is critical to making faster progress towards the Millennium Development Goals – and not just the first goal of halving the global proportion of people living on less than $1 a day. ". DFID Private Sector Department Operational Plan 2011-2015. May 2011. http://www.dfid.gov.uk/Documents/publications1/op/priv-sect-dept-2011.pdf

[36] "Growth accounts for approximately 80% of the poverty reduction that has, over the last 15 years (*sic - the World Bank researchers Chen and Ravallion (2009) say 1981-2005, not 1993-2008)*, lifted 500 million people around the world above the poverty line (*sic - not a poverty line)*." Memorandum submitted by the DFID on behalf of the UK Government. Co-Ordination For Aid Effectiveness Inquiry. House of Commons International Development Select Committee. Written Evidence, 2008. http://www.publications.parliament.uk/pa/cm200708/cmselect/cmintdev/520/520we02.htm

[37] "Growth accounts for approximately 80% of poverty reduction which has lifted 500 million people over the poverty line over the past 15 years (*sic*) ". BIS. Trade Policy Unit web page, undated. http://www.bis.gov.uk/policies/trade-policy-unit

[38] "Growth is good for the poor", 2000, 2001 World Bank working paper; Journal of Economic Growth, 2002.

[39] Performance and Innovation Unit report "Adding it Up", Cabinet Office, 2000.

[40] International Comparison Program, 2006. "Harmonizing ICP and HES Data to Calculate PPPs for the Poor". ICP News Volume 3, No. 1. http://www.eclac.org/deype/noticias/proyectos/5/14465/news_icpv3_01.pdf
Deaton and Dupriez (2009, above): "we make no attempt to use separate prices for the poor....in some countries and for

food when people can afford less of it is more important to them, whereas a "perfect" annual index would count it as less important because less is bought. Further, people may buy some food, sell some food and eat some home-grown food, which means prices affect even calculations for one family in different ways for different items at different times. Real life is complex.

8.3 But some things are simple. A person who understands business finance might say: "There is a difference between income and profit, and assets and debts are crucial to understanding the economic position of a business." They might consider the nature of economists' inferences from income to profit, and from profit to economic gain, about real families - who in many cases (farmers are an example) are their own business.

8.4 The Prime Minister made that kind of error when he referred to the "bottom line" in relation to GDP. For similar reasons to those in the previous paragraph, GDP does not show the "bottom line" either for governments or people, in any sense related to basic concepts of business or personal finance. **Some may think that conventional macroeconomic indicators of progress simply ignore non-monetary aspects of well-being. In reality they do not capture the monetary aspects either.** Income is not a welfare statistic. It is a social statistic.

8.5 These problems go far beyond the UK Government and the World Bank. Where are the academics who point out that the distribution of income does not tell us what people got in return, or whether it was enough to meet needs, or associated with changes in asset or debt levels? If economists had been concerned enough about such problems then perhaps the financial crisis would have not occurred in the same way, and perhaps the objective Millennium Goal indicators would be doing better.

9 The UK has inferred poverty outcomes without excluding demographic change.

9.1 The China one-child policy, and birth rate falls elsewhere, mean more workers per child. "Average income rise" is not same thing as "the rise in the average for individuals compared to people of their age in the past".

9.2 Cross-sectional trends in averages (of whoever is alive at each of two times) do not measure average rises. Changes in the number or proportion of people on one side of a line do not measure how many crossed it. Such inferences depends on assumptions about birth and death rates, and technically migration.

9.3 The poor are bad for growth

Survival rates show the most striking aspect of demographic change on statistics, and how social scientists' theory can be inadequate. [41] Perhaps if economists had got this right, Live Aid would never have happened, because the rich world would, when looking at the risk of

some goods, the ICP prices may reflect....the prices of international goods in a few high-priced stores in the capital patronized by the rich and by expatriates." A second problem is that among the poor, spending patterns may be different at different levels of spending. A larger problem may be that they did not look at needs.

[41] Berkley, M. Document 16 October 2001. Note of email sent to Andrew Smith MP, 15 October 2001. Mr Smith forwarded the email to Clare Short MP, Secretary of State for International Development and Britain's Governor of the World Bank.

famine, not have been looking at possible changes for the *economy* but possible outcomes for *people* - and taken the threat more seriously to begin with. A similar argument might be made about AIDS.

9.4 "03/08/2000 To: jmorduch@princeton.edu...What strikes me is that in policy debates people look at "reducing poverty" without looking at how many people die in the interim. This seems to me the worst flaw in simple economic analysis... **if the poorest die, the income figures look better...** is there any reason for the total mix of a government's policies not to be evaluated on the number of deaths among the most-vulnerable?" [42]

9.5 "11 April 2001 Subj: Economics of survival...Dear Professor Sachs
I wonder if this of interest to the WHO Commission....**if the worst-off die, we are closer to the target**...To me, **no outcome measure is humane unless it takes into account what happened to people who started the period but didn't make it to the end. If the poorest die, the average income of those alive at the end of the period will be higher**..." [43]

9.6 The global food error

"Economic statistics on "poverty" in all large-scale studies…ignore the facts that the **proportion of adults is rising and adults need more food than children**. The World Bank's method for counting the global poor suffers from this flaw. **Other things being equal, the Bank must have overestimated the reduction** in the proportion of people living on the original level of per-day consumption **considering their age and size.** A dollar a day, even if we knew its value in food terms, would not be an appropriate measure where the proportion of children is changing, as now." [44, 45]

10 Partial answers to Millennium Goal puzzles?

10.1 The World Bank failure [46] to use FAO data on rising food needs per capita [47] may provide a partial explanation for the discrepancies in reported MDG progress for poverty ("on track") versus hunger and some other indicators. [48]
10.2 The World Bank failure to take account of other needs, relevant prices, assets or debts, and the failures to estimate reliability of the spending data or the effects of demographic change on the statistics may provide a further partial explanation.

[42] http://www.mattberkley.com/morduch.htm
[43] www.mattberkley.com/survival.htm
[44] Letter from Matt Berkley to the Chairman of the House of Commons Select Committee on International Development, 25 June 2003. Emphasis added. The Chairman forwarded the letter to DFID for a response; Hilary Benn MP as Minister of State in charge of Millennium Goal matters replied to the Chairman without mentioning the food problem. Gordon Brown, Chancellor of the Exchequer, Chairman of the IMF policy committee and UK alternate governor at the World Bank, was informed of the food problem in person in 2003. Letter quoted in "Benn and UN experts differ on global food needs", 2006. http://www.mattberkley.com/Bennglobalfooderror.htm . Note: Sometimes birth rates will have fallen while life length increases. The idea of working out a "level" of human welfare is not without complications.
[45] Berkley, M., 2003. "Discoverer of global poverty error calls for statistics on survival". Addis Tribune. http://web.archive.org/web/20070223160812/http:/www.addistribune.com/Archives/2003/11/28-11-03/Discoverer.htm
[46] Chen and Ravallion, 2009.
[47] Naiken, L., 2003, FAO methodology for estimating the prevalence of undernourishment. http://www.fao.org/docrep/005/Y4249E/y4249e06.htm
[48] UN MDG Report 2011. http://www.un.org/millenniumgoals/pdf/(2011_E)%20MDG%20Report%202011_Book%20LR.pdf

10.3 Given those flaws, and the discrepancies:

What is the likelihood that the economic data have really been measuring - to the extent that such concepts are coherent - either consumption adequacy or overall economic gains?

It may be wise to discard statistical outliers.

11 Concluding remarks

11.1 None of the foregoing implies that economists, or others, are unaware of problems. But the profession is in a state of indiscipline where baseless inferences are allowed by professional organisations, to the extent that peer-reviewed journals accept them.

11.2 It is also evident that DFID did not respond to descriptions of several of these problems given in 2000, 2001 or 2003, but instead persisted in the inferences.

11.3 DFID told the International Development Committee in 2011: "making food affordable to poor families is as much about raising people's incomes through broad-based economic growth and the creation of jobs as it is about increasing agricultural production."[49] How can they know that without looking at needs or relevant prices?

11.4 Is "increasing the poor's spending" the new tied aid?

11.5 It is perhaps not unreasonable to suggest that starving people may die even from apparently small errors, omissions, or lack of attention to the true basis of particular statistics.

11.6 It would not follow from

11.7 In what way do such methods honour the ideal, of the person commemorated by the Millennium, of treating others as oneself? I am not a Christian, but I wonder if there are Christians who know the detail of the indicators and consider them to be in line with their faith. If a person would not use a method of social science on themselves in a similar situation, the method is necessarily invalid for other people. If scientists and governments cannot justify claims which form an important basis of policies, leaving the situation in place is not desirable for taxpayers or those for whose benefit the policies are intended.

11.8 Perhaps the global food price crisis might have been mitigated - and deaths averted - if (leaving aside economists' inclusion of speculators' parasitic activities in aggregations of countries' "product" or "output") those in charge of monitoring the progress of the poorest had considered relevant food prices and needs before speaking of absolute poverty trends.

11.9 This submission does not deal with wider issues about the quality of life or its relationship to economic considerations. However, the author considers those issues important. This is the Economic Affairs Committee, and the inquiry is about the role of UK aid which is with few exceptions legally bound to what seems likely to benefit people. The evidence for the influence of economic growth - which measures neither wealth creation

[49] The 2010 Millennium Development Goals Review Summit: Government Response to the Committee's Second Report of Session 2010-11 http://www.publications.parliament.uk/pa/cm201012/cmselect/cmintdev/959/95904.htm

nor the amount of productive or sustainable work done - on the poorest is not what it has been presented to be.

11.10 There is arguably little point in gathering more statistics if existing statistics are misused. Statistics on survival rates are needed to find out what happened to people; they are needed in order to interpret economic statistics; they are less prone to misinterpretation than money data, which are already very complex and expensive to produce, and still inadequate. It may therefore seem wise to prioritise survival as one aim of progress.

11.11 A problem with making economic statistics more representative of real life (apart from the even greater expense on experts and data collection) would be: **the more complexity, the less transparency.** Surveys on spending already ask dozens of questions and have difficult problems about comparison of nutritional value of different diets, quality of nominally identical products, faulty memories of people for what they bought over a certain period, lack of cooperation by rich people, lack of ability to trace the destitute, and so on. **Poverty measurement makes sense until you think about it.**

11.12 DFID's claim about how many people UK aid helps lift across a poverty line is based on the same problematic methods. How is basing policies on these methods more prudent than the methods for assessing prosperity which led to the financial crisis?

11.13 We might also ask - if money data is a reliable proxy for other things we value, then are the money data needed?

July 2011

Professor Philip Booth and Richard Manning—Oral evidence (QQ 284-337)

Evidence Session No. 9. *Heard in Public.* *Questions 284 - 337*

TUESDAY 1 NOVEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Lord Hollick
Lord Lawson of Blaby
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Professor Philip Booth, [Institute for Economic Affairs], and **Richard Manning**, [formerly of OECD's Development Assistance Committee].

Q284 The Chairman: Can I welcome you to the Economics Affairs Committee? This is the eighth public hearing of our inquiry into the impact and effectiveness of development aid. I have to say for the record that copies of Members' entries in the register of interests are available. Mr Manning, you are very welcome. Thank you very much for coming today. I understand that this session is being televised. Whether it appears is a different matter. One other thing is that we may be voting in the middle of this session, in which case we adjourn for 10 minutes and come back as quickly as we can. Could I begin by asking you one of the central questions of this inquiry? In the past, substantial volumes of aid were disbursed to low-income countries in pursuit of non-economic objectives. It is not surprising that measured aid effectiveness in this period was low. By contrast, the past 20 years have seen a concerted effort by donors to put aid on a sounder footing. Is aid more effective in supporting growth today than it was before?

Richard Manning: First of all, I thought that this was a tough and interesting question, so I went to a leading aid econometrician about it. His name is Finn Tarp, who heads the World Institute for Development Economics Research in Helsinki, which is part of the UN University. He told me that there is little broadly agreed empirical evidence on whether aid has a higher impact on growth in one decade than in another. What he does say is that, as empirical evidence gradually relates to a longer period, it is getting more credible to make conclusions as to where the long-run impact of aid is accounted for. In a recent study that he has done, he has come up with what he calls robust, statistically significant empirical support for a positive aid growth relationship for the period 1970 to 2000. But if you take a decade such as 1990 to 2000, he comments that we cannot reject the hypothesis that the treatment effect is zero. In other words, he sees an impact on a long-term horizon, but not on a short-term horizon. Now, why might that be so? It is quite logical, because if you think about it, aid is contributing to certain things that you would expect to feed back quickly into economic growth. For example, if you build a power station, that contributes directly. At the same time, if you are putting children into school, it is going to be a long time before they are productive adults. If you are vaccinating kids and stopping them dying, that will have only a long-term effect on things. So I think that many interventions that most people would support—humanitarian aid, which is about 10% of all aid these days; mother and child health; universal primary education—are simply not aimed at immediate growth as such. That led me to a question, although it is not my job to ask you questions. You use the phrase, “non-economic objectives”. Does one regard vaccination as an economic objective or not? Does one regard aid to Afghanistan as for economic purposes or not? There are questions of definition of the term “economic objectives” that may need some reflection.

Professor Philip Booth: Also not being an econometrician in this field, I looked at some of the evidence and sought the views of others. The conclusions that they relayed to me were, to put it colloquially, “We do not have the foggiest idea”. The evidence is very mixed. One study was published in the *American Economic Review* by Burnside and Dollar, which was then overturned by a later study that found the relationships insignificant.. Some studies would suggest that aid has been more effective in the past 20 years; other studies then overturn it. The reason for that is that there so many other factors that swamp the impact of aid and determine economic growth, the most obvious being good governance, the right institutional environment, the absence of conflict and so on. It is still difficult to argue against the comparison of Asia on the one hand and Africa on the other, Asia being a very minor aid recipient and African being a huge aid recipient, and the one continent having extraordinary economic growth and the other having almost none. So it is difficult to dispute the conclusion that Peter Bauer derived from the evidence, which was that if aid makes a positive impact, that impact is likely to be small, but if aid has the negative impact that its detractors suggest, that negative impact could be very large in particular cases.

Q285 The Chairman: I should have thanked you very much for your paper, professor, which was very stimulating. On that point, can you give us specific country cases where aid has had a damaging effect on growth and prospects in low-income countries? We have had quite a lot of discussion about this with other witnesses.

Professor Philip Booth: Again, because so many other factors are relevant, it is difficult to determine whether aid has been the factor. If you look at countries such as Ethiopia, Kenya and some of the southern African countries, you see that aid has been a huge proportion of national income. If you look at the record of how that aid has been accounted for and the distortion of government processes and so on that have arisen as a result of that aid, there seems to be little doubt that it has had the potential to do an awful lot of harm. Whether that negative situation would have arisen without foreign aid is simply a matter for conjecture. It is a fact that a high proportion of aid has gone to very low-income countries with very poor institutional regimes. It is therefore not surprising that we have had very poor outcomes. Whether you would have had those poor outcomes without aid is extremely difficult to determine because there is no counterfactual.

Q286 Lord Lawson of Blaby: May I echo the chairman's vote of thanks for your written evidence? It was extremely illuminating and you raised a number of very important points for this Committee to consider. I should like to ask you a specific question. Many years ago—I cannot remember how long ago it was—the international community concluded that ODA should be 0.7% of GDP. Nobody really takes it seriously apart from the British Government. They take it so seriously that not only have they insisted on using it as a guide but they are now undertaking to make it a statutory requirement. Irrespective of what is happening to the economy and in other areas of public expenditure, they have to rise to that by law. May I ask you both whether, first, there is any merit, and if so what, in the 0.7% of GDP target, and, secondly, it is sensible to make this a statutory requirement in the United Kingdom?

Professor Philip Booth: I think that it is a completely bizarre way to conduct government policy. The target comes from a commission a generation or more ago. Whether it is relevant in today's environment and whether it should be 0.8% or 0.6%, even using that commission's logic, is anybody's guess. But it is a very strange way to go about establishing government policy to determine how much you should spend on aid, given the objectives of government policy in this area, simply according to a target for inputs. Furthermore, given the poor record of aid in the past, which the current British Government accepts, to increase very rapidly the amount that we are spending within that department without the department necessarily having the capacity to deliver it effectively is equally mistaken. Most organisations would budget more rationally. If you were sceptical about the way in which aid had been delivered in the past and if, like the British Government—to give them credit, you have firm and quite well researched views on how a better aid policy might be pursued (we have some questions later on smart aid) surely the budget should be set on a policy by policy, project by project basis to determine where you can get good rates of return and effective results from pursuing a particular aid project, rather than it being set at a particular level—roughly £13 billion, as it would be in 2015—and increasing support come what may up to that level. Given the bad record of foreign aid, it should work the opposite way around, which is to raze the whole thing to the ground and then think structurally about how you might use taxpayer funds to support development in underdeveloped countries and what projects might bring about better results. Of course, the bad economics underlying this work in both directions. We will spend and perhaps waste £1 billion if we find that we reach saturation point in the productive projects that the Government can find. Let us say that the Government really did find the magic bullet with foreign aid. And let us say that it would then seem desirable to increase spending by another 0.1 or 0.2% of national income, and you could save several hundred millions of lives that way or promote growth in poor countries by doing that. The current policy essentially stops the Government doing that. It simply enshrines into legislation a very poor way, from a managerial, business and economic point of view, of pursuing policy in this field.

Richard Manning: Obviously I am coming at this with a somewhat different set of ideas about aid from Philip's, so I would take a more positive overall approach to aid, but the question of whether you set quantitative targets is interesting. It is true that the 0.7% target was set in 1970, and that is quite a long time ago. The way I see it is that we have to live somehow on a planet that is under a lot of stress, where there are very large inequalities between countries, despite the impressive growth of the emerging economies. If we take a long-period view, a 50-year view, the disparities between those of us in the UK and Malawi have grown enormously in that period. A highly unequal world is also a rather dangerous world, and the case for some continuing form of concessional transfers is very strong. The question of whether you put a particular figure on that is something of an empirical one.

The 0.7% target has been successful in a number of countries. Most of the Scandinavian countries and the Netherlands, for example, have fixed their policies with reference to this, sometimes doing more—for example, Norway provides 1%, as it can well afford to do. To that extent, it has provided a certain incentive to Governments to make a significant contribution here. I quite agree that it has to be spent effectively. It is not easy to say how you would come up with an approach to government expenditure where you funded something project by project; you have to take a broader approach to the Treasury to say, "How much does the UK want to put into this?". I have seen merits in my work in the OECD and the 0.7% target as being an encouragement to Governments to sustain aid programmes, which in many countries are never the most popular thing to do. It has this element of incentive across countries that has been useful. As to whether the target should be statutory, that is a different matter. I myself have never been involved with a department with a statutory target; it takes you to a different place.

Professor Philip Booth: I do not think the experience in the early 21st century in both health and education of budgets being rapidly increased and what happened in those departments to government productivity sent a very good signal regarding what might happen with regard to increasing the foreign aid budget very rapidly.

Q287 Lord Lawson of Blaby: Your mention of education is very much to the point. You would know more about this overview because you are academics and I am not, but I very well remember that towards the latter years of the Macmillan Government, when there was a huge expansion of university education, my good friend Kingsley Amis was extremely critical and said, "More means worse". I wonder whether that may not apply to aid. That is what we are on about here. Mr Manning very rightly pointed out the inequalities around the world today, and certainly I think all of us around the table, although I cannot speak for anyone else, wish to see the developing countries becoming much richer and their people better off. Whether we want to see the inequalities removed by wealthier countries becoming poorer is another matter, but we certainly want the former. The question is whether aid is effectively contributing to that.

Richard Manning: A figure came to my attention the other day that I thought was worth passing on. I used to deal with Bangladesh in the late 1970s. It had recently emerged from Pakistan in a painful war and there was very little there; it was producing only jute and tea. Aid was more than 10% of its gross national income. Aid to Bangladesh is still not different in absolute terms from what it was then but is now 2% of its national income. This is the country that was famously regarded by Henry Kissinger as a basket case. Bangladesh has a lot of things against it but the fact is that over a longish period it has managed to reduce its aid dependence significantly. That is pattern that I think we are going to see in Africa over the next 20 years—it is going to happen there too. Aid is essentially helping to make a transition. The way I see aid is that it enables things to happen faster than they otherwise would. These countries will develop eventually whether we do anything or not, but aid is helping them get there more speedily than should otherwise be the case. In the case of Bangladesh, I can say with some confidence that the investment that we all made in population programmes and in education are not unrelated to the fact that the Bangladeshi population growth rate is now down to 1.4%.

Q288 Lord Forsyth of Drumlean: If you think 10 years or so ahead in the poorest countries in the world, what do you see as the main impediments to growth, and what role, if any, can development assistance play in removing these constraints?

Professor Philip Booth: It is the poor institutional background. If you compare India to Bangladesh, what really caused growth to take off in India was the reforms in the post-1991 period. That is why on the whole India has performed so much better than Bangladesh. I have to say that there are many things wrong with the Indian political system and economy. Nevertheless it was that set of reforms that led to the difference. In Africa there has been a combination of often corrupt and unaccountable Governments, very high barriers to trade—not just between African countries and developed countries but between African themselves, and trade barriers themselves are a magnet for corruption—and civil conflict. Growth has increased quite dramatically in Africa in recent years. That is partly because of the commodity boom but also largely because of the reduction in civil conflict and the improvement in the institutional situation in a number of African countries.

The problem with aid in this sphere, and here I am quite sympathetic to the argument that Paul Collier makes—I gather he is speaking after us—is that the most productive use of aid is to provide institutional support in the wake of the civil conflict and so on, because if you get that post-civil-conflict phase right it can provide the background against which long-term economic growth can take place. Aid providing institutional support does not have a good record of success and is extremely risky. Again, he makes the point that this will often then be held up by the *Daily Mail* and so on as a failure of aid, but it is institutional change, better governance and so on that will lead to long-term growth in African countries.

With regard to free trade, most poor African countries are small. Unlike India, which has one-sixth of the world's population, most African countries are pretty small and if you do not have free trade between small countries, you get all the losses from not having the comparative advantage and the division of labour and so on that pertain to small countries. Basically, I am talking about the policies that we all know are necessary for growth. On how aid can support those, the jury is out.

Richard Manning: There seem to be two big issues that need to be coped with: the rise in population and increasing resource scarcity. Aid can make a contribution to both over the longer period, but it will be a modest contribution. There are three issues that aid can help directly: skills shortage, infrastructure shortage and what I would call resilience to climate change and other things, enabling countries to be better able to cope with shocks. There are three issues—the good and accountable governance one that has already been mentioned, the good management of revenues and borrowing, and trying to reduce the risk of conflict—which aid can help up to a point. There is a policy-only one, which is the trade access point that you made—trade access to the BRICs, to Europe and America and to each other.

Q289 Lord Best: Professor Booth touched on the difference between more aid and smarter aid—using the amount of money you are getting. How would you define smart aid? How could the UK's aid be smarter?

Professor Philip Booth: In three or four ways. First, there is the issue of supporting institutional change. That is difficult and risky. I should add that in general the record of aid tied to policy change where that change has been imposed from outside, particularly by the

World Bank and so on, is not a happy one. That is something that aid proponents and aid opponents are pretty much agreed on. So that is quite risky.

Secondly, the important thing is to support initiatives that arise within the country itself. You cannot do development to a country. Someone who has great experience of Zimbabwe was telling me that Robert Mugabe said in the early 1980s that his role as president was to develop the people. Well, the people cannot be developed by Governments of poor countries themselves and certainly not by outside Governments. We should support initiatives that arise organically from the bottom up. I will give you an example. In education, the work of James Tooley in uncovering private schooling for the poor is quite important. He uncovered large-scale education that aid agencies and even Governments did not know was happening, and if you simply go in with large footprints and set up free government schools using aid programmes, this could undermine private initiative that is already happening. On the other hand, providing finance to parents so that their children can go to school rather than having to go to work is supporting parents in what they wish to do and giving them the ability to choose how they do it in the context in which they live. So it is a question of supporting initiatives that arise organically from beneath, together with institutional support, although, as I say, there are some issues there that are difficult.

Richard Manning: I guess if you take a country that is well organised and knows what it is doing, it does not really matter how you deliver the aid—it will use it effectively. The problems arise the more you get into fragile states and states that do not operate very well. Some of the points that Philip made are sound, particularly on the importance of local ownership, where it exists, and trying to make institutions work better. I think that donors have usually underinvested in history; you have to understand countries more than we often do. Why are countries the way they are? There is a lot of history behind us that the people know but the guy who flies in from Washington does not. We have to do a good job on accountability, using all the techniques that we have to encourage Governments to be held to account. We are doing a piece of work at the moment, which Paul Collier and I are both involved with, looking at a whole variety of innovative ways of delivering services in fragile situations. There are many things that you can do, but I would put that in the context of how you work in these fragile environments.

Q290 Lord Moonie: Peter Bauer long advocated the view that Government to Government aid transfers were intrinsically corrosive to political structures in recipient countries. Does this still hold true, or has the gradual of democracy and increased political accountability across developing countries in the past 20 years weakened the force of the fatigue?

Richard Manning: Let us start with something else. It is common ground now that resource rents have often been corrosive in exactly the way that Lord Bauer had in mind; you get a big oil strike, a lot of money flows to a small centre and is often received by a Government. The alternative, as Mick Moore and others from the Institute of Development Studies have argued, is that tax is good for you. A broad-based tax system positively encourages business to hold Governments to account. Aid is somewhere between the two. Paul Collier wrote a very interesting paper a few years ago called *Is Aid Oil*? He went back to this thesis and asked whether aid could be corrosive in the way that oil is, and he concluded that “the hypothesis that they have the same effect can be decisively rejected”.

Professor Philip Booth: Bauer’s hypothesis did not actually rely on the assumption that these Governments were in the first place corrupt. His hypothesis really was that aid could corrupt the political system in the same way as an oil strike. If you look at countries in the very long run, those that have had large growth have on the whole not received large volumes of aid. China did not receive large volumes of aid, nor did Vietnam. It is very clear that development can take place without aid. That, I should add, was the other half of Peter Bauer's argument; countries that did not receive aid were not caught in some kind of trap whereby they did not have enough capital to develop, and so on. We should not forget that. It has been completely disproved; countries can develop without aid.

I do not think that there is much doubt that if aid is a large proportion of a country's national income or of the Government's budget, it can distort the institutions within a country. The other aspect of this, which Bauer did not really talk about because he was not a macroeconomist, is the real exchange rate effect. This seems like an esoteric point but the IMF has done work on it and found quite significant effects. Aid, rather like striking oil—North Sea oil, for example, in the UK in the late 1970s—raises the real exchange rates, because essentially you are flooding capital into a country. Although, if used well, it acts like a free gift that can raise the income of a country, it will distort a country's economy and particularly discourage export activity and so on in the same way as oil revenue can. This is known as the Dutch disease. Nothing has really changed in this respect. In fact, the better aid is spent, the more likely you are to have a Dutch disease problem from aid. Furthermore, if it is well spent on investment projects—I have already used the example of education—there is the possibility that aid can reduce the returns from private sector investment projects as well. As I say, Bauer's hypothesis was not predicated on the assumption that the recipient Governments were corrupt, so not everything has changed. Nevertheless, the evidence suggests that it is true that spending aid in environments where there is better governance produces better results or that the results are not as bad as when Governments are corrupt.

Q291 Lord Lawson of Blaby: Mr Manning referred to conditionality. Do you think that as a matter of policy we are being sufficiently tough on conditionality? Should we be seeing more, such as that you will get aid only on condition that you reduce corruption—ideally you would not have any but that is impossible; still, it is better to reduce it—and pursue sensible economic policies; that if you do not do this you will not get the aid; and, furthermore, that the aid may be of benefit only if this conditionality works? Are we being tough enough in that regard?

Richard Manning: There has already been a great discussion about this to which I think Philip has referred. Most people agree that conditionality where the donor forces the recipient to sign a piece of paper is usually not very effective because the recipient simply signs the paper, fails to do what they have agreed to and the donor finds themselves doing it again. There is a famous case in Kenya where the World Bank bought the same policy reform three times, I think. That gave conditionality a bad name. On the other hand, I completely agree that certain kinds of aid make sense only if the macro performance is right. Although many people have criticised, with some justification, aspects of the structural adjustment programmes in the 1990s, they brought Africa into the 21st century with stable macro balances and helped people within government who wanted to insist on sound policies against their own political pressures. So there is an important coalition here between external aid donors, particularly the Bretton Woods institutions, and reformers within countries around policies that we know make sense in the medium term but that are politically inconvenient in the short term. If you get it right and do not have the kind of naive conditionality that I referred to first, there is a win-win situation here, but it needs to be very carefully managed.

Professor Philip Booth: Possibly by having a credible programme whereby aid actually supports an already ongoing organic reform programme rather than saying, "You will get £3 billion or whatever if you do this". As Richard mentioned, those conditions are extremely hard to enforce and are often resented by the population, which then begins to resent the international organisations that impose them. To support an ongoing programme of reform is perhaps a more positive way of encouraging reform. To some extent, the US Government are doing that with their millennium challenge account approach.

Q292 Lord Moonie: Given what you say, do you think it is appropriate that DfID is committed to devoting proportionally more of its aid to weak and failing states? ***Professor Philip Booth***: This is the dilemma. On the whole, well governed states do not need aid, or at least it is not long before they do not need it because they tend to grow relatively rapidly, while a huge proportion of poor states are corrupt states. I go back to the answer to the first question; despite all the problems of looking at the aid budget on a programme-by-programme basis and despite all the additional administrative costs that that might involve, I would much rather that approach be taken so that all the aspects pertaining to a particular aid programme can be examined rather than simply having a policy shift from middle-income countries to poor countries, from poor non-reforming countries to poor reforming countries or from poor corrupt countries to poor non-corrupt countries, or whatever. That problem strengthens the case for going back and examining projects on a project-by-project basis.

Q293 Lord Smith of Clifton: Inevitably in what you say you are making generalisations. Could you give us one or two specific examples that would illustrate the generalisations that you are making about good and bad projects, or a good project that went wrong—something like that? It is difficult to get a handle on your general conclusions.

Professor Philip Booth: It is difficult off the top of my head to come up with specific examples right now that are easy to explain, but there are education projects, for example, which are quite well recorded in the literature—Collier, Peter Boone and James Tooley have written about them—where Governments have come in with aid programmes and established schools but there has been huge teacher absenteeism. Those schools might well have undermined the private schools that were there, and so on.

There are other case studies in a similar field where aid money has been used in order to support parents' attendance at school, which is a subtly different approach that can have very different results. Richard, you may have better examples.

Richard Manning: I am afraid that I have to say, as someone who worked within the British aid system, that I do not think one could manage a programme on the basis that Philip is offering us. The structure is much easier if you have some clear government-wide objectives for what you want to achieve with your aid programme. You then bring it down to country level and say, "In the circumstances of the countries where we are going to operate, what are the priorities for us?" After all, we are not the only donor—a lot of other countries and agencies are doing things as well. You have to fit into that space, take a long-term view—these issues are not going to be cracked overnight—and develop a sensible policy in the space you are working in. I am very hesitant about suggesting that there is any way in which you can pick projects worldwide on that basis. There are approaches that you can get right, but not projects.

Q294 Lord Shipley: Professor Booth, I was very interested in your mention of Vietnam. I think I heard you say that Vietnam had grown significantly despite the fact that it had not received aid. However, is there not a distinction between aid and investment? Vietnam has received very large amounts of both Japanese and United States investment, particularly private sector investment, and probably from other places too. Do you think that we should investigate further the relationship between aid and investment? In other words, Vietnam has grown significantly as a consequences of investment, which you have defined as "not aid", but actually there has been a large amount of foreign investment in that country that has led to growth.

Professor Philip Booth: I would not define it as aid, and the lines of accountability are completely different. If you have private companies investing in Vietnam, China or wherever, and those projects are not profitable, then shareholders suffer and they can punish managers, the value of the company will fall or the company will get taken over and so on, whereas the lines of accountability with the provision of aid are very weak. Not only are there large amounts of investment but there is philanthropic assistance. If you include remittances in philanthropic assistance, I think I am right in saying that US philanthropic assistance to underdeveloped countries is greater than all OECD government aid put together. Again, the lines of accountability with philanthropic assistance, remittances and investment are very different from the lines of accountability with foreign aid.

Richard Manning: Let us bear in mind that China and Vietnam receive huge amounts of aid money. Vietnam gets at least $1 billion a year, while China was the largest aid recipient for at least a decade until just the other day. The point is that the aid is very small in relation to their economies, particularly in China; it is a bit larger in relation to Vietnam's.

I completely agree that the success is usually measured by the inflow of investment. Vietnam is a good case and there are many others where a stable regime following sensible policies, broadly speaking—I am certainly not going to endorse everything that the Vietnamese Government do—attracts investment. Aid has played its part in that, so the two things are quite complementary.

Q295 Lord Lipsey: As well as official aid, there has been a vast increase in NGO and private philanthropic aid. Professor Booth, you seem to show a slight preference for that and hedge your bets a bit when you say that aid money is arguably better spent when it is directed through charities than when it is directed by government bureaucracies. However, having spent the summer reading the terrible twins of aid literature, *War Games* and *Dead Aid*, I must say that the examples of defects in donor NGOs in this field come out terribly strongly—for example, the disbenefits of competition. When they try to set some condition on what a Government can do, that Government can say, "Oh well, we'll go to another NGO", and the other NGO grabs the business—such as grabbing some other charity's starving baby to put in your advert. I wonder whether it really can be sustained that this is less damaging than the defects of government aid.

Professor Philip Booth: Actually, since writing that submission I have become slightly more sceptical about the benefits of charity relative to the benefits of aid. In principle you would expect those benefits to exist, since a charity has to be directly accountable to its donors. For all the faults in the systems of accountability among NGOs and charities, when charities write to me they are certainly much more effective at communicating what they have succeeded in doing than the British Government are.

Q296 Lord Lipsey: They may be effective, but they may also be lying.

Professor Philip Booth: Yes, I know. I am going to come to that. Over the summer, I had a stream of comments responding to something that I had written on aid. They said that the arguments that I had been making also applied to charitable provision. One example was Colombia and, I think, Vietnam. The arguments were around dependency and for charities essentially taking over and trying to do development for the local people rather than supporting organically what went on within the local community. These are issues that we should broach with the charities. I am not sure that I mentioned in the submission that charities have become increasingly distorted in their mission because so much government aid is provided through them. In principle, that is not a bad idea. If a Government feels that a charity is working on the ground in particular areas—in some areas of the world, charities are working where there are no government aid programmes—then in principle you would think that it would be a good thing to divert money through charities rather than have government spend it directly, but then that distorts the mission of charities. Instead of them being organisations to which people give funds to them voluntarily, their whole bureaucracy becomes disorientated and they become organisations that instead campaign for more money to be directed through them through a bigger aid budget from government. I have become more sceptical of NGO and charity work. There was a particular case study of western, politically motivated NGOs in the constitutional land reform debate in Kenya, where there seemed to be some fairly unsavoury things going on. That was another issue that has since coloured my view on the approach of NGOs to this matter.

Richard Manning: I have to declare an interest. I am a member of something called the international NGO accountability panel. This is part of a reform movement that the larger NGOs are entering into, where they all report regularly according to something called the Global Reporting Initiative, which sets a standard for reporting. I am on a panel that vets to see whether they have done that. One has to say that the NGO community is extremely diverse and we have to break it down before we make sense of it. We know that it is very effective in certain situations; we know that it is very ineffective in others; and we have to make distinctions between northern and southern NGOs. Organisations such as BRAC in Bangladesh have pulled off lots of things—say, in girls' education—that the Government would have struggled to do. One also has to worry about whether they get too large and have mixed motives and so on. It is a very interesting area in which simple answers are not very helpful. It has to be unpicked.

Q297 Lord Hollick: Over the past decade, we have seen the emergence of China, India and Brazil as significant new donors. Do you think that, on the whole, that is a good thing? Will it help economic development in poor countries? What are the implications for British aid? Do we need to rethink the way that we give aid to certain countries? The aid coming from China, for instance, often has economic ties to it, to support Chinese business to grow. Should we revisit making the commercial interests of Britain an important factor in aid to poor countries?

Professor Philip Booth: A lot of this is not aid but investment. I have looked at more case studies of the Chinese Government than I have of Brazil and India. The Chinese Government have a lot of interest in Burma, Africa and so on. It is rather difficult to separate government from business in the case of China, particularly when they are operating internationally. There is no doubt that some of what is happening is very beneficial. A lot of investment is driven by commercial considerations, leading to better working conditions and job opportunities for the people involved. What worries me is not what is happening right now but a problem of what is being called by some economists developing these ideas—Roger Koppl, in particular—a "big players" problem. What you get with huge entities that are dominating any economic situations—it can be central banks in the case of finance and investment; it can be government policy, the European Union's as well as the British

Government's, in the case of energy policy—is that instead of having entrepreneurs looking for market signals and responding to them and creating wealth, you get people trying to anticipate how these big players, who through their huge shifts in policy and capital can suddenly "game-change", to use an American phrase, will behave in a situation. People look at how they behave and create an inherently unstable situation. So it worries me that, with one-sixth of the world's population residing in China and roughly the same in India, government and business ties there are close to an unhealthy degree, and that changes in government policy could then bring about significant changes in the business environment in very poor countries and do an awful lot of damage. But the short-term benefits are quite clear.

Richard Manning: Their contributions in the form of grants are basically welcome. Significant amounts of their assistance are in the form of loans, some of which would count as aid and some of which would not, depending on how concessional they are. Like all loans, they need very careful handling in relatively fragile economic environments. It is not surprising that these relatively poor—by OECD standards—donors copy what the OECD used to do up to early 1990s, when it had a self-denying ordinance, called the Helsinki disciplines, which basically stopped OECD countries fighting commercially for the same project. But it does involve some risks. It is very important in my view that recipient planning procedures are sufficiently robust for all borrowing. When you borrow anything, you have to have good plans for how it is going to be productive and how you are going to pay it back. I worry that Governments may borrow, whether from the market, from the Chinese or from other export credit agencies, and get things wrong. So it is very important to engage the Chinese in particular, because they are by far the largest donor, but also the others, in a real discussion about the fact that it is in none of our interests to have a new debt crisis in Africa caused by an inflow of large amounts of money for not-very-good projects. Project quality is crucial; the amount of money that you borrow is crucial. I do not appreciate the way China's Exim Bank tries to get a lien on future foreign exchange earnings to make sure that it gets repaid. That is thoroughly bad practice. I think there is a lot of work to do in this area. I do not think that the answer is for the United Kingdom to go into head-to-head competition with China. For a start, we are not competitive in building roads in Africa; the Chinese are. It would be not the right kind of competition to go into in our own interests. We should have an intelligent dialogue with emerging donors and work with African Governments to strengthen local accountability and good governance so that they take a careful approach to borrowing from any source, including the emerging economies. I would also like the emerging economies to play a bigger role in the multilateral system. I was involved in the replenishments of both the Global Fund and GAVI over the past 12 to 15 months. It is disappointing to me that we are not getting larger contributions from these big emerging economies into multilateral activities. That is another angle that should be pursued.

Q298 Lord Tugendhat: It is widely thought, and it has emerged from your evidence today, that one very important factor in economic development is the quality of the governance of the recipient country. In recent years, efforts have been made by donors to tackle some of the governance problems. Would I not be right in thinking that the Chinese are not very bothered about governance and that one of the attractions of Chinese aid for some recipients is precisely that they are not going to have to listen to any lectures about how to improve their governance but they can pocket the money? Is not this a problem about Chinese aid?

Richard Manning: Let me put it in a broader context for you. I read a fascinating study by a Japanese professor five years ago that said, "Japan and Britain—what two different attitudes to development. The British say, 'We've got to fix governance and the economy will fix itself'. But we, the Japanese, think we've got to fix the economy and then governance will fix itself". There is definitely an Asian way of thinking about this, which is that you gradually change the economic structure, and that itself, over time, drives more democratic forms of government. Although the Chinese push this to a further extreme than the Japanese, you have to bear in mind that there is another way of thinking about it, which is very different from the way in which we have perhaps traditionally thought about the relationship between governance and the economy.

Q299 Lord Tugendhat: That is all very well—there are lots of ways of thinking about it—but you were saying earlier that governance was important. Now you are telling me that there is another way of thinking about it and perhaps we should not bother about governance, so why are we concerning ourselves with governance? There are some areas where there is a right, a better, a worse or a wrong way, and you are equating them, so why do we bother about all this governance stuff?

Richard Manning: I do not equate it; I am on the British side of this equation. You have to do both, but the governance side is extremely important. I remain concerned that if aid is put in the wrong way it will work against governance improvements, which are essential to sustainable growth in Africa, so I am definitely on one side of that fence.

Professor Philip Booth: I think that is right. There are different aspects to governance. It is possible for a country that is extraordinarily poor, as China was 20 or 30 years ago, to improve economic aspects of its governance—allow more entrepreneurship, have a more stable regime of property rights and so on—while being extraordinarily autocratic and abusing human rights, and get growth from a very low level of national income to quite a low level of national income, where it is now. It is still improving dramatically while also still being the sort of Government we would not want to operate in the United Kingdom. It is the autocratic tendencies and lack of—

Q300 Lord Tugendhat: It is not just autocratic. One of the things that you and so many other people who have come before us have said, rightly I am sure, is that the quality of governance in a country—namely, whether it is corrupt or not; whether the decision-making is done in an orderly and well thought-out fashion; whether the civil service works; whether the interaction between politics and administration works—is important. My impression, which you have so far done nothing to dissuade me from, is that the Chinese are not very bothered about that sort of thing but are bothered about whether the road that links the mine to the coast gets built. They are bothered about whether the objectives they have set are achieved. My point to you is that one consequence of having the Chinese as a big donor—there may be some beneficial consequences—is that it is going to reduce the pressure on countries with bad Governments, whether they are autocratic or democratic.

Professor Philip Booth: When I was talking about autocratic versus democratic, establishing property rights and so on, I was trying to resolve the paradox that Richard introduced. It is true that we do not know whether it is happening and there is speculation about whether it will happen, but there is a danger that we will get almost reverse conditionality. It could be in the interests of the Chinese Government to have recipients of foreign aid that rode roughshod over the property right and general freedoms of their people so that the road from the mine to the port still works. That is entirely possible and somewhat worrying because of certain aspects of Chinese governance that remain dramatically unreformed.

Richard Manning: I agree that it is worrying. We have to build an understanding in China that there are risks for them as well. After all, the Zambian Government have recently changed, largely on the grounds that the previous Zambian Government were too friendly with the Chinese. I think that the Chinese will gradually appreciate that if you build high-profile projects that are controversial, like this dam in Burma, they can come back to bite you. As China becomes more of an investor in countries, it too will have an interest in predictable government. We should try to build a long-term understanding with the Chinese that some things are in their long-term interest that might not be in their short-term approach.

Q301 Lord Forsyth of Drumlean: I do not know whether Lord Tugendhat wants to follow up on this, but I did not feel that he got an answer to his question. I am sure that whatever this Committee says will not have much influence on what the Chinese do. I am rather interested in what the British do. The question that I thought he was asking was whether in giving aid we should tie that to our commercial interests.

Professor Philip Booth: I do not think we should at all. That relies more or less on the lump of labour fallacy—the idea that somehow there will be more jobs and wealth here if we tie aid to a particular African country to the purchase of goods and services from the UK.

Q302 Lord Forsyth of Drumlean: So you do not think there is any role whatever in pursuing our very generous aid into government policy for trying to encourage people to support and involve British business?

Professor Philip Booth: To some extent that will happen naturally if the infrastructure is there to provide aid, but in no sense should that aid be tied to the purchase of British goods.

Q303 Lord Forsyth of Drumlean: Even though our competitors are doing the opposite?

Professor Philip Booth: This is a form of trade protectionism, and the record of most forms of trade protectionism is that even if others are doing it, it is not beneficial for us to do it. There are exceptions to that, and in a sense the Chinese create an exception because they are such a large proportion of the world market, but even then I think there are big political dangers in moving down this protectionist path.

It also raises the question of why you want to provide foreign aid. If you want to provide foreign aid to develop British commercial interests, you should pursue policies other than foreign aid. Cut the foreign aid budget.

Q304 Lord Forsyth of Drumlean: Sorry to interrupt you, but why is it either/or?

Professor Philip Booth: Unless you are a believer—which I know you are not—in industrial policy and all the things that go with trade protectionism and so on, I do not see what advantages you believe come to the British economy from tying aid to the purchase of goods and services from Britain. Surely we should allow market forces to determine how the resources in the British economy should be allocated and not say that we should tie Kenyan foreign aid to the purchase by Kenya of British arms, education services or whatever. It is better for them as well—if you get any aid bang at all, you get more aid bang for your buck if you allow the recipients of that aid to spend it in a way that is of most advantage to them rather than on specific UK goods and services. You can then spend less on foreign aid to get the same result.

Q305 Lord Hollick: It is the same point really, but is there not a danger that if everyone else is playing by a different rulebook, the aid that we put in, as well as giving no benefit to our own business interests, actually helps those of our competitors?

Professor Philip Booth: There is a danger of that if everyone else is playing by a different rule but on the whole the tendency in international aid—the Chinese situation is an exception to that but, as I said, it is also a slightly unhealthy mixture of foreign aid tied to commercial investments—the trend in foreign aid is in the same direction that we have gone, to untie it from the purchase of goods and services from the donor country.

Richard Manning: I very much agree with everything that Philip has said on this. I had the privilege of managing British tied aid for much of the 1980s. We were in a head-to-head with the French at that time, and it finishes up with a lot of aid going to not very competitive companies—many of which are no longer with us, quite honestly. I can show you the project where the piece of British mining equipment is still down the hole in Sumatra and never got used. I can show you the Westland helicopters that were not what the Indians wanted and never really flew. You make so many bad decisions if you go down that route that we should do everything we can to avoid it. The important thing is to get the Chinese into the same kind of discipline as the rest of us are already in. It is a big issue, in the WTO context in particular, to bring the Chinese along and exert the same kind of rules and regulations that the rest of us are applying. Again, that is not going to happen tomorrow, but it has to be a very important medium-term objective of policy.

Q306 Lord Hollick: And have the French gone in the same direction?

Richard Manning: It is interesting that French mixed credits, which were centre stage 20 years ago, as I am sure Lord Lawson will recall, are now trivial.

Q307 Lord Shipley: Can I ask you about the high-level forum on aid effectiveness, which was established by the development assistance committee of the OECD? Donors have committed themselves to improving aid effectiveness, but there have now been three forums—there is a fourth, I think, later this month. Have the initiatives that have been taken made it more effective? If not, why not?

Richard Manning: It is a question I have asked myself because I have been heavily involved with this process. You are right; the fourth high-level forum is taking place in Korea at the end of this month. The monitoring of what was done under the so-called Paris declaration, when we looked at some of these things at a meeting in Paris about five years ago, shows that although there is significant progress on indicators for change on the recipient-country side—some improvements in public management and so on—there has been very little progress, or at least less progress, on the donor side. This probably comes down to the day-to-day incentives that donors have for getting on with business as usual. On the other hand, the slightly broader evaluation—a more qualitative look at this—is a bit more positive. It says that there has been some progress on aid efficiency, although on the whole it has been disappointing; there has been significant improvement in the management and use of aid; and aggregate standards are improving in the partnerships between countries and recipients. The way that I saw this was that the well organised countries—Vietnam would be an example—were pretty smart at dealing with donors and did not need a lot of advice from anyone else on how to do it. Some of the smaller and weaker countries, though, get pushed around by donors in a way that does not achieve very good results—in the discussion we had about NGOs you could replace the word "NGOs" with "Governments"—and a lot of this kind of donor competition and generally not very productive behaviour has been going on. Aid works much better when recipient countries take a more assertive role. All successful countries are those that have been ready to say "no" to donors at the right time. The attraction of the aid effectiveness approach is that at least donors have said publicly that they support a certain set of behaviours, and that means that weaker Governments should be readier to hold them to account for that.

I am disappointed that the aid effectiveness effort has not got further, but it remains worth while. Aid will still be going to pretty aid-dependent countries for at least another 20 years, and the better we manage this the better off we will be. If you take a longer-term view—again, this was said in the evaluation—the current practice has much greater transparency and is less donor-driven than it used to be. Some of what has been done about untying, about aid transparency, about the debt write-off and so on is in the right direction, but it is still very much an unfinished agenda.

Q308 Lord Shipley: So if there was one thing that they co-ordinated this month, one outcome that you would really wish to see happen, what would it be?

Richard Manning: On this occasion, the most important thing is to try to reach some understanding with the emerging donors. That is the big issue at the Busan forum: how far can we have a central discussion that includes the big players that we were talking about earlier? At the same time, we have to go on delivering what we said we would deliver as OECD countries. The most encouraging document that I have seen, and I am happy to send copies of it, is a document by Africans saying what they want out of this. To my mind it is a really intelligent document, well written and well put together; it makes the right points, and I think you might enjoy reading it.

The Chairman: I would be grateful if you would. Thank you very much.

Q309 Lord Smith of Clifton: I want to talk about exit strategies. It is frequently argued that even when aid is effective and contributes to growth, prolonged engagement with aid donors can distort the incentives necessary for dynamic private sector investment. How should donors seek to manage their aid relationships in these close-to-take-off environments? How do you reach the end of the tunnel, so to speak?

Richard Manning: I think there are two things that aid could do wrongly. It could distort things in what you might call a statist direction—it gets the state to do too much—or it can spoil the market. Those are the two things you have to worry about. On the whole, the statism charge is not too strong. Donors have long argued against inappropriate government-owned industries and the like. There could be a danger of some Governments trying to do too much in service delivery but donors are investing in a variety of approaches—I referred to that before. Market-spoiling is more of a thing to watch. If donors provide assistance particularly to the private sector in ways that inhibit the development of long-term capital markets in these countries, that is a serious mistake. I am therefore always very cautious about anything that involves putting concessional money into the private sector; you need to work through non-concessional patient capital operations like the International Finance Corporation, the CDC and bodies of that kind. Where I think donors can be of the most use is in improving the investment climate and working with Governments to deal with a lot of the red tape. There is a big agenda for most Governments, certainly in Africa, in cutting the costs between factory and export. I read an interesting study that shows that the ex-factory costs in Kenya are not very different from those in China, but by the time the stuff has left Mombasa port it is uncompetitive. There is a huge agenda in this are that will certainly help take-off. There is some good experience of what is called "aid for trade" trying to focus on these areas, but Governments themselves have to crack some vested interests and deal with unnecessary roadblocks—corrupt Customs officials and the rest of it—in order to work through this. Then we will get the private sector inflow that you have been seeing in Vietnam and elsewhere and we will indeed get take-off.

Q310 Lord Smith of Clifton: Is there a role for donor Governments to tip off firms in their own countries to say, "This is a good opportunity"? This gets rather close to what Lord Hollick was talking about.

Richard Manning: I have always made a bit of a distinction in my mind between exporters and investors. On the whole I prefer dealing with investors because they have to take a long-term view, just as aid donors have. It is perfectly proper for Governments to encourage investors to look at cases. Many African countries feel that they have made a lot of reforms, but the investment has been slow moving in. In general, if they have sustained the reforms the investment has moved in, but there is a time lag and if countries like our own can encourage that to change, so much the better. One has to say, though, the private sector is pretty smart here. Governments are usually slower than the private sector. Look at mobile phones in Africa; I do not think that any of our Governments designed that, but the private sector has been extremely efficient in doing it.

Professor Philip Booth: The only thing I would add to that is the importance for getting take-off in Africa of trade liberalisation and the problems of corruption, bad governance and so on and how aid must increasingly work with the grain of achieving those objectives and not against it. This is going slightly off the point, but one of the Cadbury family was talking to me about when they were in charge of Cadbury's and they were thinking of building a big plant in India. As a result of the import controls, not the export controls, on the raw materials, it was cheaper for them to build the plant in New Zealand and ship the stuff to India than to build it in India, despite the fact that wages were probably one-tenth or less in India than in New Zealand and the distance to the market was immeasurably less.
I encourage the approach of liberalisation and, if you have an aid programme at all, doing everything possible to ensure that it does not prevent liberalisation and the development of a private sector, which is crucial.

Q311 Lord Tugendhat: You give the impression that donors are likely to be focused on the financial management and accountability aid disbursements, but do you think they place less emphasis on the efficiency of the spending of those aid finances? That is the impression that has come through. Is it a fair impression?

Richard Manning: I have some sympathy with it. I would not want to make too confident a statement, but your overall judgment is certainly one that I can understand. We have to do more to help countries focus on the impact of what they are doing. There are various ways of doing this. I was particularly pleased to see that DfID has provided assistance to the Indian Planning Commission to introduce impact evaluation across the Indian Government. That is a very constructive thing to do and I favour more of it. The kind of studies that the National Audit Office does here on value for money is the kind of thing that other countries should worry about. I was pleased a few years ago to hear the Finance Minister of Ghana say, "Look, 75% of my responsibility is to Ghanaian taxpayer, who is paying 75% of the cost of public expenditure. These are the people I am accountable to". We have to help build this sense of accountability for spending their own money; that is the safest way of protecting our contribution. I am strongly in favour of stronger audits, stronger parliamentary control, impact evaluation, strengthening civil society to hold people to account and—I have to declare an interest here because I am on the board of the BBC World Service Trust—a bigger investment in media, which can be very important. There are some good examples in all those areas.

Professor Philip Booth: Going back to the previous point about the effectiveness of aid, the reform of aid processes and so on, the documents that I have read about the various fora in which these have been discussed where the OECD has tried to improve aid effectiveness, have suggested that there has been quite a lot of progress in process and financial accountability within donor countries but rather glacial progress in the effectiveness of aid and trying to deal with the problems of poor governance and corruption within countries. It has also been suggested that donor countries have not cracked the issue of providing aid in post-conflict situations.

Those are three obvious areas where the efficiency of aid provision can be improved. A further area, which we will come to later, is the amount of aid that is provided through multilaterals. If you rank countries and organisations by the effectiveness with which they provide aid, most rankings put the multilaterals quite close to the bottom. In many cases there are good reasons for that, but in the case of the EU, for example, which I think gets about 20% of UK aid, 21% of all EU fraud is in the EU aid budget; it is certainly not simply because it is a special-case multilateral that is dealing with very difficult situations and has a large bureaucracy for other reasons. One way in which aid effectiveness would be improved is by the British Government spending more of it themselves.

Q312 The Chairman: We will be coming on to multilateral agencies shortly but, before we do, could I ask you another question following the theme of private sector investment, particularly in relation to public/private partnerships? Should aid donors be using their resources to leverage private capital and expertise into these divisional areas through public/private partnerships? Secondly, I understand that the evidence of PPP arrangements is mixed, especially among the poorest countries. Does the evidence suggest that public/private partnerships can be effective in the poorest countries?

Professor Philip Booth: I could speak on this only in principle. The evidence in the UK of public/private mixed ventures is not very good; both the proponents of full privatisation and the proponents of full nationalisation would make that point, for all sorts of reasons, including that you possibly get the bad habits both combined in one project, but also because you are perhaps helping to finance projects that really ought to go ahead if there is a financial rate of return by but the Government are actually subsidising them rather than the aid being about the provision of basic education, healthcare, vaccinations and so on. I can see in principle why you might well get problems from those sorts of public-private partnerships but I have no experience of the practicalities. However, Richard might.

Richard Manning: I will do my best. There is perhaps rather a limited area where one should discuss this. At one extreme, I do not think that Governments broadly speaking need get involved with things like industry and telecoms and I do not see how the private sector is going to get involved with rural roads and waterways and capture the financial return. We are normally looking at energy, toll roads, ports, maybe urban water and the upper end of the housing market as being the areas where this makes sense. There may be examples in education, as has been suggested, and in health. So there is scope in these areas, but we need to bear in mind that these things are typically very expensive to set up, they have to be set up in a careful way and there is often a risk that there will not be stability in the conditions. If the private sector thinks, "We're not really going to be able to trust this Government over the period of the concession", they are going to demand a very high return. That is the biggest problem. It is only if Governments are credibly going to sustain their side of the bargain in the medium term that the private sector will come in on terms that are reasonable. That is a big constraint. It is definitely not a panacea; rather, one has to look at it case by case.

Q313 The Chairman: This Committee looked at PPI in the UK a few years ago. It is a comparatively recent initiative, actually. We saw many examples of where, when it was set up, it had been badly constructed and the arrangements were very favourable to the private sector. Taking your point, are there many experiences of this operating in terms of the aid programme?

Richard Manning: I think I will have to send you a note about that. I can tell you more about the examples of where it has gone wrong. There was a very famous case involving water in Latin America, which was headline stuff. One the whole, big-city water projects are the ones that have typically gone wrong with the highest profile, but there undoubtedly are some that work. If you like, I could try to send you a note.

The Chairman: That would be helpful.

Q314 Lord Lawson of Blaby: You referred to the fact that a large amount, something like one-third, of British aid goes to multilateral agencies—the European Commission in particular but also the United Nations agencies. You also said that all the evidence suggests that the problems with aid effectiveness are there in spades when it goes through the multilateral agencies, particularly the European Union as far as value for money is concerned and regarding the corruption problems that you alluded to. Do you think that we should cut back on that and change the proportion significantly, on the evidence, which I think is largely accepted by DfID? Do you think that it has gone wrong because the aid budget is now so large and still growing, whereas every other public expenditure programme is being cut back, and it is being shoved out to the multilateral agencies simply because DfID does not have the capacity to more of this itself?

Professor Philip Booth: Britain has always provided aid through multilateral agencies, so I am not sure that the extent to which this has happened is because of the growth in the aid budget. I am not sure of the figures on the extent to which aid to the multilateral agencies has increased. In principle, though, one would expect extraordinarily weak accountability within these organisations. We are having this discussion here; aid is regularly discussed among the electorate in general elections and so on, and, given the store that the Government have set by their aid promise, I am sure that if they cannot demonstrate aid effectiveness at the time of the next general election it will become a big issue. None of these things happens when you distribute aid through multilateral agencies, or if they do they happen they happen only indirectly. As I say, if you look at any of the measures of aid effectiveness, they certainly give the appearance of being worse for multilateral agencies. There may be some areas where multilateral agencies do things that individual Governments simply cannot do, and there may be situations in which there are good reasons for opponent inefficiencies, perhaps because they are involved in more risky projects and so on. But that does not seem to be the case with aid provided through the European Union and it certainly cannot excuse the very high fraud figure in the EU aid accounts.

Richard Manning: Let me give you one answer about the multilaterals in general and another about the European Union. On multilaterals, it is worth bearing in mind that in the 1980s the multilateral share of British aid was usually around 45%; it is actually a good deal lower now than it has been historically. Again, the EC has always been a large part of that since we joined. I think I have to take issue slightly with my colleague over what the evidence says about the relative efficiency of bilateral and multilateral aid. An index has been created recently by the Centre for Global Development in Washington, the Brookings Institution, which measures 31 agencies, bilateral and multilateral, against four criteria, and this is how they score. On maximising efficiency, the top five are all multilaterals, the European Commission is 11th and the UK is 12th. On fostering institutions, three of the top five are multilateral, the UK is seventh and the EC is 12th. On reducing the burden, three out of the top five are multilaterals, the UK is one of the bilateral in the top five and the EC is ninth. On transparency and learning, two of them are multilateral, one of them being the EC, and the UK is 13th. To give you a figure on efficiency, the median project size for IDA, the World Bank's soft loan agency, is $22 million, while the median size for USAID is $116,000.

These are in a different business. You need to break the multilaterals down. Let us start with the multilateral banks. It is a very clever set-up. The multilateral banks borrow on the market and then lend to middle-income countries with a mark-up. Thanks to that mark-up, they can attract and retain very high quality staff. They are therefore an important international repository of knowledge. They still get things badly wrong. They tend to be arrogant and all the other things we know about these institutions, but they are a fantastic international investment and we need to make good use of them. They undoubtedly have an important role.

Multilateral aid is always untied and somewhat less political than bilateral aid, and there are certain things that it is very quick to do. I should declare an interest because, as I have said, I have worked with both GAVI and the Global Fund. Look at what they do. Take a simple intervention; you want to vaccinate children. It is not very complicated—why do you want a Belgian, a Luxembourg, an Irish or a British programme to do that? Why do we not pool our money in GAVI and let it do this? That is, broadly speaking, what we are doing. If you want to get insecticide-treated bed nets across Africa, the same applies; the Global Fund is doing that very effectively. Upstream pooling for simple interventions is what multilaterals can do well.

I am certainly not going to defend multilaterals against all the criticisms that exist. Every one of them needs to be held to account and some of them are definitely inefficient. By the way, I think DfID's review is quite a serious piece of work, and I give it credit for having taken this seriously and come up with some very transparent conclusions that one can discuss.

On the EC, I observe in the review that the British divide this into three parts. The European Development Fund gets one of the top markings along with the humanitarian part. It is the European Commission's budget programmes that get the lower marking, not least because the main part of these programmes will go to middle-income countries, particularly in the European neighbourhood. In my view, what has happened is that Europe has chosen largely to communitise, if I can use that word, aid to its immediate neighbours. There is virtually no British aid to immediate neighbours of the EU and there is not a lot of bilateral aid from others, either—there is some but not much. In a way, you have to ask yourself: is it intelligent or not for the European Union to have a common approach to providing assistance to countries that either are potential members of have a long-term close relationship?

There is also great scope within the European Union to improve the way that the Commission and the European Investment Bank work together. It is high time that the EIB set up a subsidiary that brought together its assets on lending outside the EU, and I would like to see a more systematic approach to that. I would like to see the EU have some higher-level professional skills in-house. It is anomalous that the World Bank has a well known chief economist and the European Commission does not run to one. There are many things that could be done to improve it.

It is also going to be important to see how this new European external affairs service works. As you know, this is the new Foreign Office, as it were, of the EU, and I worry that if it is not carefully managed the EU programme may become rather politicised. We need to keep an eye on that.

I would not be inclined to reach very black and white judgments about the multilaterals; I would be inclined to look carefully at individual multilaterals en bloc, what we want them for and which are the ones that we should be investing in.

Professor Philip Booth: I take issue with the suggestion that it is necessarily a good thing simply to aggregate these things at a higher and higher level. Arguing that Belgium having its own vaccination programme or whatever would be ineffective. I think this misunderstands how entrepreneurship and the discovery of economic ideas actually works. Look at the role of the Rotary, which is a charity, in polio eradication. It financed one-fifth of the polio eradication process. Then it got involved in the provision of bed nets and, through a Rotary initiative, simply entrepreneurially discovering a better way of doing things reduced by 90% the cost of delivering bed nets to a particular African country, an approach that was then copied by the development agencies. If Rotary had just given money to bigger agencies that would not have happened. I am simply not a believer in bigger is better, getting more and more economies of scale and all the rest of it. Actually, sometimes you lose the essential entrepreneurship that sometimes produces solutions that you would not otherwise get.

The Chairman: I wish we had more time to explore this. You have raised a lot of interesting questions in your response, Mr Manning, which we will certainly wish to study. Time is moving on, though, and we will have to move to the last question because I fear a vote is coming up shortly.

Q315 Lord Forsyth of Drumlean: In a couple of sentences, how would you assess the overall effectiveness of DfID? How has it changed over time, and has there been any change since the change of Government in 2010?

Richard Manning: I used to work in the place, so take what I say—

Lord Forsyth of Drumlean: That is why I said, "in a couple of sentences".

Richard Manning: One has to say that a very important event took place in 1964, the results of which are still with us. In 1964 the incoming Government took the decision to put together all Britain's aid assets in one place. They took the people who dealt with the multilateral banks in the Treasury, FAO in the Ministry of Agriculture and so on, and put them all together in one block. Governments of both stripes have kept the same system ever since, so the British, unusually, have always had an agency that has basically managed the entire aid programme, both bilateral and multilateral. That is its key strength, that it is able to do that. Its extensive professional knowledge is also another key strength. When I was at the DAC, I must say that always I found the British very well organised. They tend to get criticised in the OECD because they are too pushy and they think they are always right, and a bit more humility is probably a good thing for the British generally. Fundamentally, though, there is a good product there. I am not very well equipped to say what has happened since the change of Government, but I fully support what Andrew Mitchell is seeking to do to strengthen the results agenda within this. That is very important.

Q316 The Chairman: We have only three minutes before we have to rush and vote, so could we please have your answer very quickly?

Professor Philip Booth: I want to comment on what has happened since 2010. There is no doubt that Andrew Mitchell has a passion for this subject, and I think he has a pretty keen understanding of what actually generates economic development. He genuinely believes that aid can support that process rather than undermining it. If there is a failure under the coalition to deliver more effective aid, that will almost be a final indictment of the aid agenda, because, as I say, he has a keen understanding of what is necessary for countries to develop. A particularly interesting case study in this regard is Pakistan, where David Cameron put a lot of store on a form of conditionality for increasing aid to Pakistan—Pakistan's Government increasing the proportion of income that they derived from its own people through taxes, improving educational opportunities in certain respects and all the rest of it. That is quite transparent and he will be held quite strongly to account if that fails.

The Chairman: Thank you very much. We had better stop there. We have been going at a very rapid pace and you have given us a lot of food for thought. Thank you very much indeed for coming.

Examination of Witness

Professor Paul Collier [Oxford].

Q317 The Chairman: Professor Collier, thank you very much for coming. I am sorry that we are a little bit late, not least because of a vote, but we have been much looking forward to this session with you, not least because you have been much quoted in earlier hearings. Perhaps we should start with your much quoted and hugely influential book, *The Bottom Billion*. In that book, you suggest that aid may have added around 1% per year to the growth rate of the poorest countries of the world during the past 30 years, a contribution which you characterise as, "a holding operation preventing things from falling apart". Your assessment views aid as probably necessary in some form for development, but certainly not sufficient. We shall explore aid effectiveness shortly in this session, but could we start by asking to explain briefly the basis for your "necessary but not sufficient" view?

Professor Paul Collier: It is clearly not sufficient; I do not think anybody would claim that it was sufficient. I do not think that I would even claim that it is necessary, but it can certainly be useful. Historically, it might indeed have been necessary to reduce the number of countries that fell apart and to pull back those that did. We see from Somalia the enormous costs of what happens when a country really falls apart. The lesson of Somalia is basically that whatever it costs to avoid that situation is money well spent. The developing world went through a kind of post-independence trajectory which you can partly chart from the different dates when they got independence. It is roughly a half-century trajectory of initial governance and economic policies deteriorating a lot. Then, after about 30 years or so, they bottom out and start to crawl back again. These are big sweeping generalisations but that is roughly the pattern. The early independence countries like India come out first and the late independence countries like Zimbabwe come out last. So, for a lot of the period, aid was against a background of deteriorating policy and governance—which it did not cause. Aid is much exaggerated in its effects in both directions. It did not cause the deterioration, but the backdrop was one where things were basically headed down. What aid did was kind of slow down the descent; it did not avoid it. Then it does help on the recoveries. In countries such as Uganda or Ghana, post-meltdown, aid helps the recovery process. That is as far as I would want to go.

Q318 Lord Tugendhat: Can I ask a question to which I genuinely have no idea of the answer. You talk about "a holding operation, preventing things from falling apart" and then you give an example. Somalia is a most dreadful example of the cost of what happens when things fall apart. To what extent was Somalia a recipient or not of large amounts of foreign aid? Can one say that Somalia has fallen apart despite getting a great deal of foreign aid or that Somalia has fallen apart not as a country that did not get much foreign aid?

Professor Paul Collier: I have to admit that I do not know—it is a really good question. I do not really know the degree of donor engagement with Somalia prior to falling apart. Aid is part, a relatively minor part, of a portfolio of donor engagement. Maybe Somalia was inevitably going to become Somalia whatever we did. We should not exaggerate our degree of influence in sovereign states. But some others came pretty close to being Somalia. Ghana comes down by the early 1980s to a nightmare; Sierra Leone comes way down. You are on the verge of a number of Somalias. Somalia has been such a no-go area for such a long time that I have never engaged with it.

Q319 Lord Tugendhat: What role can aid play in promoting and supporting growth strategies geared to employment generation and wealth creation, which underpin political stability? In other words, to what extent can it help political stability quite apart from economic development?

Professor Paul Collier: It is quite clear that the message from north Africa is an agenda of jobs and justice. There has been a neglect of job creation in the whole economic discourse in Africa. It has been a huge policy failure of governance that has not been sufficiently prominent in the donor discourse. For example, labour market data are the weakest area of market data. The discourse has been about growth but not about jobs. That needs to change—it will change now because the new IMF is the street. Governments are scared of their own street, quite sensibly. There is a lot that international development can do for stimulating growth strategies that generate jobs, and aid can be part of that. To leap ahead a bit, one phenomenon that I hope will happen over the next decade is that offshoring from China will spread from low-income Asia. China is already starting to offshore stuff; its share of manufacturers in the US peaked a couple of years ago and is already falling, because Chinese wages are rising so rapidly. At the moment, it is offshoring to Bangladesh and Vietnam, and the opportunities for coastal Africa break into that. What will help that is a mixture of our trade policies and our aid policies. Our aid policies can divert from the social agenda on to the economic infrastructure that is needed to support manufacture export zones. It is not very fancy: the ports have got to work; the power has got to work, and that costs some money. Trying with DfID and the G20 to get a trade policy initiative that would privilege Africa would be an example of co-ordinating a trade policy with an aid policy. That is the sort of thing that DfID needs to learn to do, and DfID is much better placed to do than other aid agencies, because it has some span of policies. It is even better placed than the multilaterals because the British Government have a voice in European Commission trade policy; the World Bank does not. Do you want me to talk on to the next question, which is on the private capital markets?

Q320 Lord Smith of Clifton: That is my question. More well managed low-income countries are looking to private capital markets to fund infrastructure and other public investments. Can aid be used to help poor countries access private capital without exposing their public accounts to excessive credit and exchange rate risk?

Professor Paul Collier: That is the really exciting frontier of aid. It depends on where private capital markets have got to now. I deal a lot with private investors. Private investors know that they have too much in the OECD. That is a matter of regret; they wish that they had not invested as much in it. Where do they want to invest? They wish they had it all in the bricks. The only trouble is that their grandmothers know exactly the same, and so it is all in the price. The assets in the bricks are not cheap, so the smart money has to look beyond what your grandmother knows, and that is going to be Africa. There is a lot of investor interest in Africa, but everybody also knows that it is complex and risky. It is just above private investors' comfort level. There is now something that was not scope for a few years ago. There is now scope for public money to just bear some of the risk.

Lord Smith of Clifton: Sort of PFI schemes

Professor Paul Collier: Yes. The changing CDC is very important. The Dutch equivalent of the CDC, the FMO, is already doing that pretty successfully.

Q321 Lord Smith of Clifton: Whereabouts? Can you point to one or two successful examples?

Professor Paul Collier: I could get you an answer for that.

Lord Smith of Clifton: Please could you write to me about that?

Professor Paul Collier: Yes. It certainly would not come from CDC yet, because it has only just changed. I know from private investors that CDC has already changed and is getting positive responses where it used negative; for example, there is a post-conflict fund, which is useful.

Q322 Lord Smith of Clifton: If you have the Dutch example, that would be very helpful.

Professor Paul Collier: Yes, but the Dutch are ahead of the curve. MIGA is just an insurance scheme, but MIGA has been unable to recover only one claim that it has paid out on. All the other claims that MIGA pays out on, it is able to recover in the end. So what MIGA offers is a buffer between African Governments and business sector. Why this is a huge opportunity is that the world risk-free real interest rate at the moment is zero. The real interest rate—the real return—that investors want in order to move into Africa is about 20%, because they see it as so risky. You can get five categories of political risk insurance from MIGA for a total charge of 1%. You get rid of a whole load of political risks for 1%; your borrowing costs of risk-free capital are zero; and you are left with 19% at the moment; and the commercial risks in Africa are not 19%. So there is huge scope now for public capital to get private capital into its comfort zone. Commercial investment in Africa is probably by no means more risky than commercial investment in the OECD because the growth prospects are so much better. Investing into a growing environment is a lot safer than investing into sagging demand.

Q323 Lord Hollick: Are there any other measures that Governments could take to facilitate and promote private investment? I think you are saying that we are almost at a turning point.

Professor Paul Collier: Absolutely. The other side of that is the policy environment in African countries. Let me enlarge that. I have a concept which I call "investing in investing", which is trying to build the capacity of African societies to be good environments for investment. There are three pillars to investing in investing. One is to improve the process of public investment management, because public capital and private investment are complements. The public sector puts in the roads; the private sector puts in the trucks. Roads without trucks are not very promising, and trucks without roads are not very promising. They are complementary returns, so long as the public investment is properly chosen. The quality of the public investment process in Africa is at the moment very poor and needs to be improved. You can improve stuff that you can benchmark.

The Chairman: I am sorry; we have another vote in the House. We will try to get back as quickly as we can.

The Committee suspended for a Division in the House.

The Chairman: You were still in full flood, I think.

Professor Paul Collier: I was indeed. I was arguing that there are various ways in which donors can help Governments improve their investment climate. I advise the IMF, which in March launched something called the public investment management index, which benchmarks 70 Governments around the world on the quality of their public investment process in some detail—how good is your project selection, your project implementation, your evaluation and so on? Anything you can benchmark you can then improve. The most spectacular example is the World Bank's investment of the private investment climate for doing business. The Rwandan Government—a very impressive Government—has said, "Right, we're 140th in the world on this index", and the President has tasked Ministers to improve different parts of that each year. In six years the country has gone from 140th to about 60th, overtaking some of Europe—not that difficult. That is a real example of where, once a Government get serious, by benchmarking they can do something about it and track their own efforts to improve.

DfID has had a strong engagement with the Rwandans in helping them improve that investment climate. It has been a collaboration between a development agency and the Government themselves. That is then serving as a model for other countries. Three weeks ago I was invited the address the presidential retreat in Nigeria, a hugely important country. I gave the example of what the Rwandans had done and said, "You are currently number one hundred and suchlike; why don't you task your ministerial teams to improve?". So we will see.

Q324 Lord Shipley: We talked about borrowing. The counterpart to safe borrowing is effective spending. What do you think aid donors can do to improve the quality and efficiency of public spending in low-income countries?

Professor Paul Collier: This is probably my most controversial area of policy engagement at the moment. You are quite right that the battlefront has to shift to effective public spending, and a lot of countries do not have it. Again, the principle is: first, measure it. The IMF makes a start with a thing called PEFAs, which measure the quality of the public spending process. They are inadequate, though; for example, they do not include any audit, and without an audit you really cannot tell what is happening. It is an evaluation of the system from 10,000 feet rather than of whether the money is actually being looted. You need measures of both integrity and effectiveness of spending.

Q325 Lord Shipley: Is that audit an audit of the accounts, as in: was the money properly spent?

Professor Paul Collier: It is an audit that would actually give advice on what the outcome could have been had the money been better spent. What is needed first and foremost is the form—independent audits that just ask, "Is the money actually spent on what it is supposed to be spent on?", because in a lot of countries we are a long way from that. Then you can move on to efficiency audits. What does the money actually buy? They need to get as rapidly as possible into that sense of how cost-effective their spending is, but they are not even at the first level yet. I want to see a much expanded measure of the quality of public spending with a rating system. That measure could be done partly by the IMF and partly by the World Bank—which has a whole emphasis on public spending processes—but I would also be inclined to bring in the KPMGs of this world to do a professional independent audit, and then I would come out with a ratings system. There should be a threshold rating system below which a Government should not be eligible for budgets. After all, with budget support the quality of what you get can be no better than the quality of the public spending process. So I would want to see, first, a rating system linked to a threshold below which you do not do budget support.

Q326 The Chairman: What are the obstacles to achieving that?

Professor Paul Collier: My friends in African finance ministries support this for two reasons. One is that they say, "We know that we'd be below the threshold. We know why and we know how to fix it. If there were this sort of rating system and we were below the threshold, the President would just say, 'Do whatever it takes to get us over the threshold', and that would fix it". That is one point. The other point is that they say, "If only we could then get over the threshold, we could get all this donor micromanagement off our backs". That is indeed the best way to spend aid: let it empower a competent Government. There is a lot of resistance from the donor agencies, including, I should say, from DfID in the past. The concern was: how would we spend the money? That is a very revealing and shaming comment; it is saying, "We know that they're below the threshold". I just think that that is a terrible response. I was at the annual meeting discussing this with the British managing director of the World Bank, Caroline Anstey. She was very keen on this. This is starting to get into the realm of the politically do-able. It has to be linked to alternative ways of dispersing aid in environments that are below the threshold—ways in which you still spend the money but you do so with a much more hands-on approach. Otherwise, we are not credible in saying, "Because you're below the threshold, we won't give you the money". What should happen is that once they are below the threshold, there should be a period of, say, three years where we say, "We're going to try to work with you to get you above that threshold, but if at the end of three years you're not above it then the budget support is taken out".

Q327 The Chairman: That is above it having an effective audit system in governance of the—

Professor Paul Collier: I think so, yes. We know that in these environments they are much more subject to the pressures of corruption than we are, so the quality of their public spending processes needs to be at least as good as our own because the pressures for bad spending are so much greater. At the moment, their public spending checks and balances are very much weaker than our own. Sorry, that was a long answer.

Q328 Lord Hollick: You have been reading the new programme research into improving the quality of public service delivery in low-income countries. What policy lessons do you draw from the work, and what role do aid agencies have in supporting the changes?

Professor Paul Collier: Specifically, we are working on basic service delivery—health and education—in fragile states, so it is not just about low income but about environments where the 1950s European model of the state doing everything is just not credible. Donor agencies have been very reluctant to abandon that model. A lot of African Governments got this model in the 1950s and it was the model that was around when they got independence in the 1960s, so they have felt that that is what they should aspire to. The donor agencies have had this mantra of building an effective state, which means making them look like Scandinavia. At its best, that is very good—some countries can do that. In a fragile state, though, it is just not a realistic agenda for the next decade or two. Yet they have the most urgent needs on earth, so you need a strategy that can work in the short term in delivering services.

The fundamental reason why service delivery through the state has collapsed in fragile states is that the public sector has failed to get its workers to internalise the objectives of public service, so from the bottom to the top you have public sector workers who just have not internalised the mission of delivering education to children or healthcare to people. Nurses loot drugs and sell them on the private market; teachers do not turn up. The average teaching day is about one hour and 20 minutes in Tanzania, I think. One of my colleagues studied why 10 year-olds in Nigeria are illiterate even though they are at schools, and the answer is that a lot of their teachers are illiterate, even though they ostensibly have certificates of education; either they bought the certificates or they have just lost the skill. They have not internalised the fundamental idea of what it is to be a good teacher.

Alongside that terrible collapse are some of the finest basic service delivery organisations on earth, which you find in the churches, the mission hospitals and the NGOs. If you compare them, you find that the pay levels are lower in these organisations and they are radically more cost-effective. They have succeeded in getting their workforce to internalise the mission. The tragedy is that for an effective organisation of service delivery, you need both a motivated workforce and scale. The public sector has the scale but not the motivated workforce, and the churches and NGOs have the motivated workforce but not the scale. It is much easier to scale up a motivated organisation than it is to motivate a big but unmotivated organisation. To my mind, the solution is to channel public money, at scale, into this church/NGO sector, and in return for that money make it accountable. The NGO sector is a kind of Government minus accountability, so you have to build structures that actually discipline it. That is the line that we are working on now: mechanisms for scaling up that service delivery by holding it to account.

Q329 Lord Lipsey: Perhaps I could turn to another of your specialised subjects, which is conflict. One of the things that we keep coming up against as an inquiry is that the need for aid, objectively measured, seems worse in places riven by conflict, but of course it is much more difficult to make aid effective in conflict-riven societies. What are the lessons of your work for how to do that? Have the Government internalised those lessons in building stability overseas?

Professor Paul Collier: So, what are the lessons of my work? One is that it is very hard to get to peace once you are in conflict. There is no good way of getting back to peace. Once you have got back to peace, that is the window of opportunity. These post-conflict situations are hugely important. If it takes a long time to get to post-conflict, you had better use that moment. In that moment, the donors have a lot of power because we are paying for the budget and often providing the security, so we have an unusually high degree of influence. The fantasy that we have been pursuing as an international donor community is that what these countries need is an election and democracy and that we can then rapidly let go. My own work in other countries points to the fact that that is just not true. You are dealing with deep-seated problems. Think what the Allies did in post-war Germany and Japan. They were very cautious in giving power back to the Governments of those countries; it was a long process of gradual localisation of power. Yet in more recent post-conflict situations, whoosh—within two years, elections and a legitimate Government. We need a much more careful trajectory. We should be much more cautious about these post-conflict elections, for a start. Then the principle is: keep it very simple and do not overload the agenda. In Afghanistan we massively overloaded the agenda. What was going to happen in post-conflict Afghanistan? It was going to fix our drugs problem, for a start, and it was going to achieve gender equality. Basically, it was going to become Denmark in two years. This was preposterous.

What can we do in these situations? Start with the money. The politics that you inherit post-conflict is likely to be dreadful because the political class will be crooked. You need first to change the political class, and that takes time—think a decade of gradual change. How do you help that process? You keep public money clean, because the crooks' power base is looting the public purse. That finances their patronage systems. Your only hope of decent politicians coming out of the woodwork is to make it very hard for the crooks to run their patronage systems. I would start with the principle of ensuring that the budget process in post-conflict situations is absolutely clean. That requires an army of accountants to come along with the money. When he finished in Bosnia, Lord Ashdown said in his little book, "'What I realised I needed was not Doctors Without Frontiers but Accountants Without Frontiers". That is right. That is the first insight: clean public spending processes.

The second is that you need some quick wins. You have to do things that pay off in the short term. If there is no short term, you never get to the long term. Donors are great at this sort of long-term vision but not very good at thinking, "So what's got to work in the short term?". It is jobs and basic services. Where do you generate jobs? Not in a puffed-up public sector. That is the road to something overblown and unsustainable. The only realistic place for job creation in a post-conflict environment—which is fundamentally uncompetitive in anything that is internationally tradable, except for natural resources, which do not create jobs—is in reconstruction, the construction sector, which can generate masses of jobs. The irony is that that employment by the locals is often how we bring in jobs. The ultimate nonsense is what the Angolans are doing; bringing in the Chinese to build cities, which means zero local jobs. Think post-war Germany: the German population literally clearing rubble. Now think of Haiti in the past year, post-earthquake—the rubble is still there.

Q330 Lord Lipsey: The other part of the question was: have the British Government latched on to this yet?

Professor Paul Collier: DfID is way ahead of the game. There is still a long way to go. There is still a deal of romanticism in post-conflict policy, although rapidly diminishing. Reality in these situations is so unpleasant that the temptation not to face it is very high. As soon as the international community gets around the table at an international conference, it is in happyland, where there is comfortable language that presupposes stuff that is just false. The one group that has had to face reality is our own military.

Q331 Lord Moonie: I take it from that that you think DfID deserves its reputation for being an innovative and effective aid agency—in which case, given the increased budget that it is going to have, what should it be doing and possibly not doing to justify the continued confidence of the British Government in the people in it?

Professor Paul Collier: We can be proud of the DfID that we have and of the one that Andrew Mitchell is building. He is doing a very good job in taking DfID into an age of new opportunities where there is a lot of private money that could be brought in. The first principle is to be honest with the British people. There have been years of Governments not being honest with citizens and of overclaiming for aid. All this language of partnership is comfortable but it does not match reality sufficiently closely. The British population has become very suspicious. The starting point is to be honest. An honest message is: yes, these environments are often corrupt and risky, but it really is important that we help to turn them around. There is a limit to what any outsider can do, so we must expect sometimes to fail, but success means that we both satisfy the objective of compassion and help ourselves. A growing Africa would benefit Britain more than anywhere else on earth.

If the first principle is to start from a position of honesty, the second is to try to develop a portfolio—bed nets plus venture capital, if you like. These are euphemistic terms. The bed nets are the practical things you can count on in a results agenda: here are the number of children alive today because of DfID. Regarding the venture capital stuff, whether it is literally venture capital or a sort of social venture capital, very often we cannot realistically measure the results for years. The right ting to do there is be honest but have a sufficiently strong component of the portfolio where we can say , "Here are the visible benefits in units that people really care about". That supports a set of things that are more important but harder to measure.

Q332 Lord Best: I think you have answered a lot of the set of questions that I was going to ask you. You have said that aid should increasingly be concentrated in the most difficult environments; you believe that DfID is up for that and we recognise that too. You have said that that means that it is not just DfID that must accept more risk and more failure but the general public. You have given us the way to the hearts and minds of the public, which is to be proud of our achievements and make them clear—that we have saved lives and that action has worked. If one is in these difficult countries and fragile states, is there a problem that DfID is quite high-minded about corruption and good behaviour, whereas we may have to accept that in these risky environments there are going to be some legitimate losses to the aid programme? Can we reconcile the public to this and ensure that they are not totally put off by our going to places where some of the money will go amiss?

Professor Paul Collier: There are legitimate and illegitimate losses, and I do not think we should tolerate illegitimate losses. This is not a matter of imposing our values on others. Let me assure you, looting the public purse is illegal everywhere. The African Governments have a problem of enforcement of their own laws. It is not that their standards are wrong; their problem is enforcement, and we had better help them with that problem. Because these are risky environments, we will have a legitimate rate of failure. If we do not have a legitimate rate of failure, we are not taking any risks. That is a concept that people can understand; it is normal. It is the softer end of the venture capital model. We are not saying that nine out of 10 things will fail but we should be comfortable with two out of 10 things failing. We have been too soft, not just DfID but generally, on tolerating misappropriation. It is not just that the money leaks; it is not wasted—it is captured, by the very people who are the core of the problem. That is why we have to address it.

Q333 Lord Forsyth of Drumlean: Could I ask you about your view on the business of setting an arbitrary target as a percentage of GDP for development aid? What do you think about it, and does it send out the right messages about our approach to development aid?

Professor Paul Collier: I think we need to develop a discourse with the population about the fact that supporting development is very much more than aid. Aid is almost a sideshow in the portfolio; there is trade policy, economic governance policy—where we can do an awful lot—and security. Those are the four legs, but aid is the one leg that receives 99% of the attention. It is perhaps a matter of gradually educating the population out of that. Could you just remind me of the other question?

Q334 Lord Forsyth of Drumlean: Is it right to set an arbitrary target as a percentage in legislation?

Professor Paul Collier: The idea of a target can help. It is a co-ordinating device across countries. That is the purpose of it—to say, "No country wants to give a lot of aid but we will if you will", that sort of thing. It is not foolish to set a target. I am much more sceptical about setting it in long-term legislation because the future is not at all clear. Maybe we should aim for aid tapering out over the next few decades and other forms of support becoming more prominent. I am a bit sceptical of legislating for it because that sets it in stone and implies that it is a permanent feature of the world. As a co-ordinating device, though, the fact that Britain is going to achieve 0.7% increases the degree of shame on the countries that are not doing that.

Q335 Lord Forsyth of Drumlean: You do not think that it sends out a message that is contrary to many of the things that you have been saying to us today because it puts an emphasis on inputs as opposed to outputs?

Professor Paul Collier: That is very much why I said that I thought aid was overemphasised. I would not have given the 0.7% target anything like the profile that it has.

Q336 Lord Forsyth of Drumlean: I understand that point. I am making a separate point. By focusing on the amount of money—

Professor Paul Collier: It is input-driven? I am sympathetic to that as well, yes. The main reason why we should do it is that we said we would. There is a big value to keeping one's commitments. That is the overwhelming reason. I am speaking in a *Spectator* debate tomorrow night and that will be my main point; to a considerable extent, aid is not about Africa—it is about us. If we want a fast way to lose our self-respect, I fear that saying, "I'm sorry, we're hard up so we're going to cut our budget to the poorest people on earth" is a fairly good way of doing so. Since the coalition won the election on the platform that it was committed to aid, it should do what it said it would.

Q337 The Chairman: Professor Collier, in the interests of time we have cut out one or two of the questions that we wanted to ask you, but there is just one more, not least in view of the response that you made briefly to an earlier question about China. We have had a lot of questions about China, India and Brazil put in front of us. Obviously, the emergence of all these major non-traditional donors has had a big effect. What implications does it have for the design and the future of the UK programme?

Professor Paul Collier: It enormously increases the importance of getting the Chinese into the multilateral system, as a microcosm of the much more general issue of trying to get China and the other emerging economies into the global system of rules and co-operation. We should be doing it on aid and on natural resource management. That is the first lesson: to try to pull them into some degree of co-operation. It is no good saying to the Chinese, "This is how it's done; come and join in". They would have to be given the power to co-design a new architecture—in my book, a pretty different one. The Chinese have a lot of investment funds, and maybe we should be thinking of joint institution architecture that manages them. So far, we have been overinclined to say, "Here are the rules. Why don't you follow them?", and that is not going to work.

The Chairman: Professor Collier, I am sorry about the interruption early, which has meant that the timetable has gone beyond what you were expecting. I know that you need to get away. I express the gratitude of the whole Committee for having you in front of us today. It has been a very valuable session for us. Thank you.

Gordon Bridger—Written evidence

To: The Clerk to the Committee

Evidence on use/misuse of British Aid Jan 12

Attached please find a fairly brief summary note which I hope their Lordships will be able to consider. I can expand on it if you think it worth while – might be a bit long.

I would like to emphasize that I am not against foreign aid in principle, and a short while ago, when Mayor of Guildford, I went out to Uganda at my own expense to start a link between a town there and Guildford (this "micro aid " link if carefully administered can be successful), but when I was there I discovered that DFID (for whom I had worked many years ago) was GIVING the Government of Uganda some £80m per year largely in the form of budgetary. There were also 45 DFID staff in the High Commission.

I know Uganda quite well having visited first in 1961, having led the first UK Aid Mission to it in the early seventies, and had teams of economists working in the Ministry of Finance for several years. To give this massive amount of aid to the Government, as every concerned person I met agreed, was appalling.

I then enquired of DFID staff why we were giving what everyone in the profession knows is unauditable aid to Uganda and was told that the project type aid , for which as economist in what was then ODA I had been responsible, had now been abandoned, as it was impossible to disburse aid in any other way. This was because the administrative systems of recipient Governments had become less efficient after independence, and because there were so many aid agencies fighting to disburse funds. As one DFID staff member stated "the amount of aid going to many African countries is causing inflation, distorting exchange and interest rates and supporting incompetent dishonest Governments".

I have had a lifetime of working for national and international aid programmes and I am saddened at the way that massive, and increasing amounts of our taxes are used to support corrupt regimes.

I joined Barbara Castle in the late 1960s as a Senior Economic Adviser, and was promoted to Economics Director for all country programmes for 7 years. That was a long time ago, but I have continued to take an interest in aid and development.

I attach some Summary thoughts which I could expand upon if you think their Lordships would be interested.

Hon Alderman Gordon Bridger

A TRAGIC TRAJECTORY

FROM A DEVELOPMENT MINITRY TO AN OVERSEAS INTERNATIONAL WELFARE AGENCY.

SUMMARY

The huge and increasing amount of public funds being disbursed BY DFID (and others) to developing countries are, on balance, doing more harm than good, serving to support incompetent corrupt regimes, and because of the manner they are disbursed – mainly in the form of annual grants to public bodies – are not auditable despite DFID claims to the contrary. Since National Auditors cannot why should external, usually inexperienced staff, seldom auditors, do any better?

Compared with the 1960s and 70s there are now a vast number of donors, all fighting to disburse fund. There are far fewer deserving recipients, and many Governments are far more inefficient and corrupt than they were in post independence days.

In the last few years many developing countries, by liberalizing their economies and allowing individuals more freedom have made significant economic strides, but since most of DFID funds go to the public sector this undermines their work.

Development is a process which must be driven by local people and Governments and cannot be the result of foreign aid – which can help at the margin. Foreign aid is making many countries aid dependent and the driving forces behind the current policies are the vested interests of the aid "industry", bolstered by an arbitrary unrealistic aid target set decades ago, and supported by a well meaning minority who are understandably moved by television pictures of distress in recipient countries and think that money can solve their problems.

There is a simple moral and political solution by which British aid could be reduced with benefit to British taxpayers and recipient countries. That is to implement David Cameron's pledge in the Conservative Aid Manifesto in which he says that the sacrifices made by British taxpayers would only be acceptable if "if every penny is spent effectively".

Budgetary type aid is not spent effectively and like Barbara Castle he should insist that only aid which can be audited should be disbursed. This would mean a dramatic reduction in aid over the years. The fact that this meant that the UK Aid target was not achieved, would not worry any but those with vested interests in aid.

Patrick Carter and Jonathan Temple—Written evidence

1. This submission seeks to answer some of the questions outlined in the call for evidence of the above select committee inquiry. We have only answered a few of the questions, concentrating on those we feel best qualified to address. Foreign aid is a complex topic and the messages which emerge from the academic literature are rarely unambiguous. In some areas, policy has to be partly or largely based on judgment. Those best qualified to make these decisions are those with extensive practical experience, which we do not have.

How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, what has been the impact of British ODA? How robust are results from studies in this area?

2. There are two central problems when assessing the growth effects of aid using statistical evidence. The first is that aid is not randomly assigned to countries, and the second is that statistical models are necessarily based on a relatively small number of countries.

3. The first problem, non-random assignment of aid, means that researchers using statistical evidence always risk conflating the effect of aid with the effects of country characteristics that influenced the decision to give aid. To make this clearer with a concrete example, countries with relatively good governance may be more likely to receive aid, other things equal. But then it is hard for researchers to separate out the effect of aid from the effect of good governance.

4. The second problem – small samples – will be partially resolved over time, as longer spans of data become available. But for now, the combination of these two problems means that studies in this area are generally not robust. Small modifications to the underlying assumptions can have a major influence on the overall findings.

5. It is also worth noting that the majority of the statistical estimates correspond to 'average' effects over a period of history in which the political, social and economic context has changed markedly, including the end of the Cold War. When aid is examined using statistical methods, it is not clear that the past is a good guide to the future.

6. Similarly, the evidence relates to the 'average' quality of aid, and there is no particular reason to think that DFID is the average donor. The UK is frequently ranked above-average in attempts to evaluate donor quality. (See, for example, Knack, Rogers and Eubank (2010), "Aid quality and donor rankings", World Bank Development Research Group, May, working paper 5290.)

7. A more detailed review of the literature, which expands on some of these points, can be found in Jonathan Temple (2010), Aid and Conditionality, in Dani Rodrik and Mark Rosenzweig (eds.) Handbook of Development Economics, Vol. 5, Elsevier, 4415-4523. http://www.sciencedirect.com/science/article/pii/B9780444529442000057

How does economic growth in countries which experience large surges in ODA compare to similar countries which do not?

8. The central problem in answering this question is that surges in ODA will often be related to changes in the circumstances of the recipient country. For example, if a country democratizes, or its governance improves, that might attract greater inflows of ODA. But then it is hard to separate the independent effect of ODA on growth from the effect of better governance on growth. Statistical evidence that relates changes in growth to changes in ODA will tend to conflate the two effects.

9. This problem has not yet been satisfactorily resolved in the statistical literature. There are a number of studies which suggest that a surge in ODA has a positive effect on growth, at least in a subset of recipient countries; and a smaller number of studies which suggest a negative effect. But simply counting the papers on each side of the debate could be misleading, because the quality of the studies (in terms of statistical rigour) varies widely.

10. Another concern with much of the relevant evidence on this topic is that aid is assumed to have an effect rapidly, whereas some of the most important effects may take decades to appear. If aid is primarily directed at alleviating poverty and meeting basic needs, any effects on productivity indicators are unlikely to be immediate.

How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?

11. In 2009, OECD Development Assistance Committee member countries donated around $120bn, representing 0.31% of these countries' combined gross national income. If these countries reached the 0.7% target, this would imply a 124% increase in ODA to around $270bn (figures in 2009 current dollars, based on data from the OECD DAC Aid Statistics webpage).

12. At present, half of aid recipients worldwide receive aid flows that represent over 3% of their GNI and a quarter of recipients receive aid that exceeds 10% of GNI. In Sub-Saharan Africa, half the recipient countries receive over 10% and a quarter over 15%.

13. What would happen to these figures if the 0.7% target was met? If the proportional division of aid between countries were to remain unchanged, half the recipients worldwide would receive aid over 7% of GNI, and a quarter over 23% of GNI. In Sub-Saharan Africa, half would receive aid over 23% of GNI, and a quarter over 32%. If aid to large recipients, such as Afghanistan, China, India, Iraq and Pakistan, were not increased when generosity increased to 0.7% , that would entail adding one or two percentage points to these figures.

14. Central government taxation revenues in Sub-Saharan Africa range between 5 and 40% of GNI, with an average of around 16% (although the underlying data are not complete). For many countries, achieving the 0.7% target would be likely to imply that aid receipts surpass taxation as a source of government revenues. However, in that eventuality, allocations across countries could be adjusted to avoid excessively high aid intensities.

15. It could be argued that these figures have little relevance to the aid debate within the UK. Other DAC members may be unlikely to achieve the 0.7% target in the immediate future.

16. Another important point is that aid need not take the form of government-to-government transfers. When absorption by domestic governments is a relevant constraint, some of the increased aid could be directed to NGOs and global initiatives, just as some recent aid has been directed to global health initiatives, including those which address HIV-AIDS.

In what ways, if any, can the British government improve the effectiveness of its development aid?

17. A suggestion sometimes made is that bilateral donors should not spread their efforts and expertise too thinly. In particular, it would make good sense for many of the world's bilateral donors to each operate in a smaller set of countries than they do at present. If widely adopted, this approach would lessen the problems that arise for recipient countries when they have to deal with multiple donors. Another benefit is that, if bilateral donors concentrated their efforts to a greater extent, this might also encourage specialization and the development of greater country-specific and area-specific expertise.

18. As background for this proposal, the problems that arise for recipients when donors operate in many countries are discussed in Acharya, Fuzzo de Lima and Moore (2006) "Proliferation and fragmentation: Transactions costs and the value of aid", *Journal of Development Studies*, 42 (1), 1–21. They argue that it would make good sense for bilateral donors to reduce the number of countries they each seek to assist.

19. A second suggestion would be to emphasize ways in which ODA could complement the accountability of domestic recipient governments to their citizens. An important criticism of ODA is that, where it accounts for a significant fraction of government revenues, there may be adverse long-run consequences for domestic state capacity and accountability. It might be possible to overcome these concerns by, for example, making aid conditional on domestic revenue generation to a greater extent, an approach that has been recommended by Adrian Wood, among others.

30 June 2011

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Center for Global Development—Written evidence

By Mr Owen Barder[50]

What is aid for?

1. Governments give aid for many reasons. As well as seeking to improve the lives of people in developing countries, they also want to increase the supply of global public goods (such as international law enforcement), project their prestige, promote the security of their citizens, win export contracts, and support their own suppliers. These goals are not mutually exclusive. In the UK the law requires that aid is used to contribute to poverty reduction but it does not prevent the Government from having regard to these other objectives when choosing which people in poverty to help and how.[51] In this submission the *effectiveness* of aid is considered with reference to its impact on people in developing countries, and not with respect to these other possible goals.

2. To understand whether aid is effective we need to be clear what it is intended to achieve. Aid is often regarded as having two purposes: *humanitarian aid*, to alleviate suffering usually in an emergency, and *development aid* to promote economic growth and sustained prosperity. But this is a false dichotomy: most aid falls into neither category. About 60% of bilateral aid, and 66% of British bilateral aid, is spent on improving services such as education, health, water and sanitation. This aid is not a temporary humanitarian response to an emergency, but a long-term contribution to the provision of key services and an investment in the institutions needed to provide them in the future. This aid may possibly strengthen economic performance in the long run, but it is not likely to lead to faster economic growth in the short or medium term. **The purpose of most aid is to improve the living standards of the citizens of developing countries by contributing to key services.**

Table 1: Bilateral aid in 2009 categorized by broad objective

	UK Aid	Aid from all donors
Aid related to growth Infrastructure, agriculture, production etc	18%	22%
Aid to improve living standards Health, education, water, NGOs etc[52]	66%	60%
Humanitarian aid Emergency aid plus refugee costs	10%	12%
Administrative and unallocated	6%	7%

Source: Calculations by the author; OECD Development Assistance Committee CRS database

3. It is attractive to think that aid can accelerate sustainable economic growth and so 'do itself out of a job'. But providing basic services to people who need them is also a legitimate goal in its own right, irrespective of whether doing so accelerates economic

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[51] International Development Act (2002) http://www.legislation.gov.uk/ukpga/2002/1/contents
[52] Budget support is assumed here to be used predominantly (80%) to support social sectors.

growth. There is a sound economic case for increasing total welfare by a modest programme of redistribution which gives very poor people access to essential services.

4. The effectiveness of aid can therefore be judged by the extent to which it brings about one or more of the following objectives, to which different people may attach different weights:

a. **sustained economic growth** resulting in permanent improvements in living standards;
b. **a better quality of life** for people in developing countries; and
c. **the alleviation of suffering** by the provision of emergency humanitarian relief

Does aid lead to economic growth?

5. Economists have applied increasingly sophisticated econometric techniques to try to establish whether aid leads to economic growth. In the 1980s, some studies found a positive and significant effect of aid on growth, while others found no effect at all.[53] These finding triggered a further wave of studies that sought to either disentangle or refute the results. Some scholars argued that aid does lead to growth in some circumstances—such as where there are good policies or export shocks, or where institutional quality is high.[54] Other studies argued that aid works on average, but with diminishing returns.[55] Recent studies continue both to challenge and to support the hypothesis that aid leads to growth. One study by researchers at the Center for Global Development found a strong, positive effect of a subset of aid on economic growth, with diminishing returns.[56] An influential study by IMF researchers found no evidence of an effect under a number of model specifications.[57]

6. The most compelling conclusion from all this is that of David Roodman, who argues that it is inherently difficult to use cross-country regressions to assess the impact of aid on growth.[58] The sample size is too small (about 80 countries) and there are numerous possible determinants of growth, many of which are highly correlated with each other and so difficult to distinguish statistically. Furthermore levels of income are an important determinant of aid volumes (donors give more aid to poor countries) so it is difficult to use statistical tools to distinguish the effects of aid on growth from the effects of growth on aid.[59]

7. The statistical difficulties of establishing a clear relationship between aid and growth should not be interpreted as evidence that no such relationship exists. Given the modest volumes of aid, we should not expect an impact on growth which is bright enough to shine through the statistical fog. The safest conclusion is that cross country growth regressions do not have sufficient statistical power to tell us whether aid leads to growth, still less to answer the more important question of which kinds of aid are effective and which are not.

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[53] Gupta and Islam (1983) and Levy (1988) found positive effects; Singh (1985), Paul Mosley et al. (1987), and Boone (1994) found no effect.
[54] On good policy: Burnside and Dollar (2000); on export shocks: Collier and Dehn (2001); on institutional quality: Collier and Dollar (2002).
[55] Hadjimichael et al. (1995), Durbarry et al. (1998), and Hansen and Tarp (2000), among others.
[56] Clemens, Radelet and Bhavnani (2004).
[57] Rajan and Subramanian (2005, 2008).
[58] Roodman (2007, 2008).
[59] Roodman's *Guide for the Perplexed* (2007) offers a non-technical introduction to the statistical issues.

8. Nor does the inconclusive evidence on the effects of aid on growth mean that donor countries are powerless to promote sustainable economic growth in developing countries. Industrialized nations have many other policy choices which are at least as important as giving aid. These include action on trade policy, climate change, immigration, conflict resolution, arms sales, corruption, research and development, technology transfer, illicit financial flows and international tax cooperation. The UK ranks poorly (16th out of 22 countries, a fall from 5th place in 2005) in the *Commitment to Development Index* which assesses how the policies and actions of rich countries affect developing countries.[60]

Does aid improve living standards in developing countries?

9. There is extensive evidence to show that significant aid does reach intended beneficiaries and provides them with key services. The quality of life in developing countries has improved appreciably over the last fifty years, even in countries where incomes have stagnated or fallen back, and aid has contributed significantly to these gains.[61] For example, about 80% of the world's children now get basic vaccinations, saving about 3 million lives a year, and over half of vaccinations in low-income countries are financed by foreign aid.[62] The UK Department for International Development estimates that each year British aid pays for 11 million children to go to school – more children than the UK government educates at home but at 2.5% of the cost.[63]

10. Advances in rigorous impact evaluation have enabled us to measure more precisely the difference made by specific kinds of intervention. For example, a project in Kenya to provide deworming drugs reduced pupil absenteeism by a quarter and proved far cheaper than alternative ways of boosting school participation.[64] Evaluations like this enable us to identify the effects of individual programmes, financed partly or wholly by aid. But we cannot say for certain whether the existence and extent of each programme was entirely due to aid, nor can we say with certainty whether offsetting or complementary choices were made as a result of aid. Aid is fungible, whether provided as projects or financial assistance. Nonetheless, with at least the degree of rigour with which we assess the impact of domestic spending, we can make a clear link between aid and quantified and significant improvements in the well-being of people in developing countries.

Unintended consequences of aid and limits to absorptive capacity

11. Large-scale foreign assistance may also have wider impacts which are detrimental to long-term development. The possible aggregate effects include undermining the development of domestic institutions, eroding the accountability of the government, entrenching interest groups that present obstacles to development, and driving up the real exchange rate and so making the export sector uncompetitive.[65] There are documented examples of all these possible consequences of aid but not enough evidence to determine whether they are sufficiently common and significant to out-weigh the benefits of aid. If these effects are disproportionately worse at high levels of aid, then there may be

60 Center for Global Development, *Commitment to Development Index* http://cgdev.org/cdi/
61 Kenny (2011)
62 See Claudio Politi and Alaina Thomas (2010).
63 DFID (2011).
64 Miguel and Kremer (2004).
65 Glennie (2008); Rajan and Subramanian (2009).

diminishing marginal returns from aid, and this could imply a limit on the amount of aid that developing countries can absorb before it starts to do more harm than good.

12. In principle donors should be able to limit, and perhaps eliminate, these unintended but foreseeable consequences of aid by improving the way they manage aid. The internationally-agreed agenda for better aid effectiveness sets out some necessary steps.[66] For example, donors could help countries to manage the macroeconomic effects of aid by making aid much more predictable and less volatile. They could avoid undermining institutions by channelling aid through government systems instead of separate project implementation units. They could limit their effect on domestic accountability by making aid significantly more transparent, and eschewing externally imposed policy conditions. In practice, however, progress has been glacial, because donors face domestic political constraints which limit their ability to make the necessary improvements.[67]

Focus aid on its comparative advantage

13. Aid constitutes only a small proportion of the resources available to developing countries, although it contributes a significant proportion of external resources in sub-Saharan Africa.

Table 2: Development finance aggregates (2009)

$ billion	Developing countries	Sub Saharan Africa
Total ODA	128	42
Government expenditure	5,509	267
Foreign direct investment	247	28
Private portfolio flows	120	4
Remittances	308	21
Memo: GDP	*18,066*	*892*

Sources: OECD DAC; IMF World Economic Outlook; Migration and Remittances Unit, World Bank

14. Other financial flows such as domestic revenues, private investment and remittances are unlikely to benefit disadvantaged groups as much as they do more powerful groups in society. This may entrench existing inequality and marginalisation. These sources of funding are also likely to underinvest in the supply of global public goods. By contrast, aid can be used to reach women and girls and the poorest communities, and to increase the provision of global public goods. The greatest value from aid may be obtained by systematically targeting it on objectives to which it makes a distinctive contribution and which other sources of finance are unlikely to reach.

15. Economic growth and private investment are key drivers of development and poverty reduction, but it does not follow that they should be high priorities for aid. There are other sources of finance for investments likely to support these goals. Donors wanting to give more priority to growth can also look to their 'beyond aid' policies such as trade and technology transfer.

[66] As set out in the Paris Declaration (2005) and Accra Agenda for Action (2008).
[67] Barder (2009).

Ten suggestions for better aid

16. The analysis thus far suggests that donors should target resources on objectives which other sources of finance will not reach, and find ways to overcome the political obstacles to effective aid so as to minimize the possible adverse effects of large aid flows.

17. Britain's reputation for providing high-quality development assistance is a considerable asset for its prestige and influence overseas. The quantitative indicators in the Quality of ODA (QuODA) index tend to confirm the view that Britain's aid is among the best in the world.[68] But the competition in this league is not strong, and changes are needed by all donors, including the UK, to improve aid and to reduce its unintended consequences. Ten proposals are listed below, for which further analysis and evidence can be provided on request.

1. Spend more aid through the multilateral system.
Multilateral agencies are, on average, more effective than bilateral agencies.[69] They impose a smaller burden on recipients, and are less susceptible to political volatility. There is a collective action problem analogous to traffic congestion: even if a private car is the most attractive choice for a particular journey, in general people would reach their destination more quickly and cheaply if everyone were using public transport. Similarly, aid as a whole would be more effective if more of it were provided as core funding for multilateral organisations. Yet only 27% of all aid (and 34% of British aid) is spent through contributions to multilateral organisations.[70]

2. Make aid more predictable.
The loss associated with lack of predictability of aid has been estimated at 15% to 20% of its value, using financial market models to put a price on uncertainty.[71] At current levels of global aid, this means a loss of about $16 billion a year. Donor governments enter into long-term commitments to purchase battleships or to pay pensions: they should do the same to increase the productivity of aid.

3. Make aid transparent, accountable and traceable.
Transparency and traceability do not solve the problem of proving the overall impact of a particular aid programme – because of fungibility and other broader effects of aid. But full transparency does narrow the scope for corruption and waste, improve service delivery and reduce administrative costs. It would also make aid administration more accountable to taxpayers in donor countries. The net benefits of transparency are conservatively estimated to be worth about $3 billion a year, and may be substantially larger.[72]

4. Build the accountability of governments to their parliaments and citizens
An unwanted consequence of aid is that it can undermine the accountability of governments to their parliaments and citizens. Donors could reduce this risk by strengthening and using recipient countries' own systems for budget allocation, execution and accountability, and being transparent about aid, so that recipient country parliaments can hold their

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68 QuODA is produced by the Brookings Institution and the Center For Global Development. http://cgdev.org/quoda.
69 Birdsall and Kharas (2010). http://cgdev.org/quoda.
70 OECD DAC Database: http://stats.oecd.org/qwids/
71 Kharas (2008)
72 Collin, Zubairi, Nielson, and Barder (2009).

governments to account for how resources are used. More attention is also needed to strengthening feedback loops so that public services are accountable to the citizens whom they are intended to serve, and not only to top-down evaluations of aid.[73]

5. Focus on results and simplify aid

Linking aid to results would send more aid to where it has the greatest impact. A focus on results should be the basis of simplification and cutting red tape, and increased recipient country ownership. Rigorous results measures should substitute for, and not be additional to, burdensome processes to monitor inputs and activities. The *Cash on Delivery* proposal is intended to allow developing countries to develop, implement and be domestically accountable for their own programmes, while allowing donors to be sure that they are disbursing only for results that have been achieved.[74]

6. Invest more in global public goods, especially new technologies

The returns from investment in global public goods are potentially much greater than from country-level aid.[75] Research and development are particularly important, because the patent system does not provide adequate incentives for private sector investment in products most of whose beneficiaries are poor. Donors should invest more in development of technologies of value to developing countries, including in health, agriculture, energy and information technologies. Other important global public goods include protecting the environment, biodiversity, international law enforcement, financial stability, peace and security, and disease surveillance and control.

7. Focus aid on women and girls and chronic poverty

Investments in women and girls represent among the very best value for money for aid. For example, doubling the rate of secondary schooling for girls has been shown to lead to a significant fall (64%) in infant mortality.[76] Aid should be targeted to reach the 400 million people living in chronic poverty – families who will otherwise be stuck in an intergenerational cycle of poverty.[77] These groups are unlikely to benefit from other resource flows.

8. Leverage the private sector

Where there is a market failure, or the market is of too little value for the private sector to be involved, it may be more efficient to use public funds to change incentives at the margin than for the public sector to step in and provide those goods and services itself. For example, five donor governments and the Bill & Melinda Gates Foundation have encouraged private investment in new vaccines by making an Advance Market Commitment which stimulates private sector engagement in pneumococcal vaccines for developing countries.[78] This approach of using aid to change the incentives of the private sector has wide application in many other situations.[79]

9. Use innovative finance to increase the productivity of aid

Innovative finance mechanisms have potential to increase the productivity with which aid is

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73 See Development 3.0 by Shanta Devarajan, World Bank Chief Economist for Africa http://blogs.worldbank.org/africacan/development-30-0

74 Birsdall and Savedoff (2010). See http://www.cgdev.org/section/initiatives/_active/codaid

75 Conceição (2003).

76 Levine, Lloyd, Greene and Grown (2009).

77 Chronic Poverty Research Centre, *2009*.

78 Barder, Kremer, and Levine (2005).

79 Kremer and Peterson Zwane (2004) and Elliott (2010)

used. They can improve incentives of implementing agents (e.g. payment by results), enable optimization over time (e.g. bringing forward vaccination), secure value from commitments (e.g. bringing down prices by entering into long-term contracts) and diversify risk (e.g. through insurance schemes). There is considerable scope for innovation of this kind. Donors should not, however, be lured into 'innovative finance' proposals which have no effect on the productivity of aid but serve mainly to increase aid budgets by bypassing donors' own budget processes.

10. Learn more and fail safely

The aid system lacks sufficient mechanisms to innovate, test ideas, fail safely, iterate and adapt.[80] These are key characteristics of a successful complex adaptive system. Donors should create more incentives and funding for rigorous impact evaluation, especially through randomized controlled trials where possible. They should build a culture and political context which accepts and learns from failure, and which scales up successful programmes. Aid programs should be judged by the performance of the portfolio as a whole, and not judged by the performance of each individual investment. These are challenges not only for aid agencies but for the legislators, auditors and media who hold them to account.

30 June 2011

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Mr John Chown, Chown Dewhurst LLP[81]—Written evidence

1. The Enquiry is concerned with development aid but this, as explained below, needs to be backed up by technical assistance. What follows (essentially in response to Question 12) is based on my personal experience of public policy work both formal and informal, at home and abroad. This experience strongly suggests that by far the best way of achieving a successful outcome is to revert to the procedures used by the Know How Fund.

2. Humanitarian aid requires hard cash to address immediate problems, but development aid should be regarded as a capital investment into building longer term prosperity for the beneficiary country. It follows that this must be carefully targeted and, as discussed widely in the literature, poor countries are often poor because of inappropriate government policies. Advice on how to create a suitable legal and economic structure and provide a framework for analysing and executing specific projects is therefore essential. Many of us working in Russia in the 1990's probably achieved a far better return for a few millions than the billions spent on direct aid.

3. Advice is only effective if it is followed. Not all countries have proved as receptive as Russia but advisers do need to ensure that the advice given is not only good, but is well-targeted and followed up by active assistance in implementation. (Even with a corrupt government, honest people can sometimes respond to advice discreetly given.) Only too often, the procedures adopted result in beautifully written and expensive reports which gather dust on the shelf.

4. The present U.K. government is endeavouring to cut the deficit, and is generally aiming for better services for a reduced cost. The aid budget is actually to be increased, and needs to achieve more than a corresponding increase in the benefits. (There is no specific allocation of the aid budget for technical assistance.) How can the government most effectively help countries develop their own economies in a cost-efficient way? One danger, which I am sure is fully recognised, is that a commitment to a certain level of expenditure may simply result in officials searching for projects (regardless of their value) so that they can "meet targets" and "tick boxes".

5. The best work on technical assistance is often provided by late career or active retired professionals, civil servants and academics with the help of young graduate students and other assistants. Such people have proved more than willing to help, but although it was a delight to work with the old Know How Fund, only too often the problem is the rigidity, bureaucracy and general inefficiency of some of the aid agencies. Those seeking to help have to waste too much time, not on helping beneficiaries (which they enjoy), but in filling in tedious forms and trying to operate within an unrealistic, arbitrary and unhelpful structure (which they don't). Indeed, many years ago I had occasion to tell the then British EU Commissioner that there were countries out there needing help, people very willing to provide help, funds voted by the European Parliament to finance it - and a whole bureaucracy in Brussels dedicated to keeping these three factors apart! The Know How Fund was extremely effective but many other, far more expensive projects have produced no useful results whatsoever.

[81] www.chowndewhurst.com

6. William Easterly[82], a former World Bank economist, beautifully described and explained the problems with which useful and willing people had been faced. This book, and his subsequent writings, should be required reading for anyone involved with international aid, and doubtless other witnesses will be discussing his views in more detail. To summarise, he says that there have been too many "grand plans" when the most viable solution to development is to have no plan, hence "the tragedy of the West spending $2.3 trillion in 50 years and not solving the simplest problems." He divides people involved into "planners" and "searchers" with some of the aid agencies being dominated by the former: "the attention to grand plans takes the pressure of the rich to help the poor even if the plans being laid are fundamentally flawed". The "planners" have no real accountability, while "searchers" get a direct feedback from the clients they are trying to reach.

7. This explains why so many useful people, natural `searchers', very willing to help at a fraction of their normal fee rates, are so discouraged by the approach of the aid agencies and why projects put out to tender are often won by large consultancy firms, more skilled at the required box-ticking than on delivering appropriate reports. (The huge amount of money which used to be spent by government on "consultancy" is another result of this approach.)

8. The first step is to bring together opportunities to give specific help and people who can carry out the projects. The wrong kind of aid agencies request <u>tenders</u> based on detailed terms of reference setting out what <u>they</u> think needs to be done and then dividing up the task to fit in with <u>their</u> preconception of the type of experts needed and precisely how many days each expert would need. In one case, we were faced with a precisely defined list of twelve `experts' needed and although I fitted one (international tax), it was obvious that they could never find the exact faces to fit the other descriptions, and they resisted the suggestion that these slots could be covered by two or three people with broad skills who could then recruit their own assistants. This was not followed up and the project produced no real results.

9. In contrast, the Know How Fund had a team who took the decisions aided by expert consultants who would keep them up-to-date on what needed doing, and sensible people with a good practical background (in my case an active, semi-retired civil servant) whose role was to liaise between countries needing help and those able to provide it. They would seek out useful people who were interested in helping, get to know them personally and appraise their competence. When a project came up, they would discuss informally with potential team members how it would be handled, work interactively with them, and build up a team whom they knew would work together well. This produced far better results than asking for tenders from rival teams leaving no scope for picking the most appropriate people from each.

10. Rather than attempting a fully costed and worked out master-plan prepared by people who had made no real study of the problems, the best way forward is to commission a team of two or three who are paid a to prepare a "scoping study", visit the country concerned, have preliminary conversations with key people in the public and private sectors. In my experience, this (with good, on the spot administrative back-up: UKTI at the British Embassy is generally excellent) need take not more than a week. Those undertaking the scoping study would then be <u>encouraged</u> to bid for the eventual project. A good co-

[82] William Easterly: "The White Man's Burden: Why The West's Efforts To Aid The Rest Have Done So Much Ill And So Little Good." Oxford University Press, September 2006. Reviewed in World Economics, October-December 2006 by Carol Graham.

ordinator can tell the difference between someone genuinely trying to do a cost-effective assignment and those trying to make work for themselves.

11. There is no need to set out sequentially how the team will tackle the problem. What they do in week two will depend on the results of week one ("searching"). They can follow up rewarding lines of enquiry and abandon those which proved to be dead-ends. There is also no need to recruit a full team if the key people know they have a potentially available budget for recruiting extra help as and when needed. It is easy enough to find such people once a firm offer can be made to them: such people are unlikely to have the time or inclination to fill in long forms on the off-chance that there will be a role for them.

12. The advisers need support, rather than detailed interference, during the implementation stage and it helps to have an unbureaucratic approach to expenses. (It is much simpler to agree an overall basis (e.g. per flight, or per night away, without formal documentation.) They need a really good bilingual local (ideally a young high-flyer in the public or private sector) who can make arrangements, act as interpreter during, meetings and keep in close touch by email as the project develops.

13. The aid agencies tend to insist on `deliverables' and to have specific recommendations build into a detailed report. The best tactic can actually be to convince the key official that he thought of it first. We achieved a fast reaction to a problem from the Russian Ministry of Finance were when there was no paper work at all (and no `deliverable' to tick the bureaucratic boxes) and we simply talked to the Minister. It is far easier to get ideas through if one does not need to take credit for them, and a written recommendation can give an opportunity for those with an interest in blocking it, to stop it happening.

14. Officials may resent taking advice from foreigners but are sometimes more willing to learn from their successful neighbours, who can often be persuaded to help. Different government departments often prove to have been looking at the same issues from different points of view and excellent results can often be achieved by means of `shuttle diplomacy' between them.

15. In the 1990's, certainly in the early days in Russia, a huge amount was achieved at a relatively trivial cost. Dmitry Vasiliev, then head of the Russian Securities Commission, had a `Resource Secretariat', with lots of space where visiting advisers could hot-desk. Those of us working there used to meet over lunch or drinks after work, discuss what we were doing, sort out duplications and generally work as a collaborative team. Different aid agencies (or even departments within them) were asking separate people to produce essentially the same information. By co-ordinating, we were able collectively to achieve much more.

16 On a major project (not in Russia), I commented, on my third scheduled visit, to the (very helpful) local World Bank office that I knew exactly what needed to be done, but it would need at least two more visits to "engineer consent." They were rather surprised at the expression, but compromised on a fourth visit. I explained that I would need to talk to many people about possible objections. Where these were valid, the advice could be adapted, and where there has been a misunderstanding, the adviser must explain the point better in the context of the country's economic and political situation. That will still leave those who publicly pretend to support, but privately lobby to block changes adverse to their special interest. Changes are never made by simply adopting a foreign consultant's report. Implementation involves many levels of several departments of governments both at the civil

service and at the political level, and any proposals have to be manoeuvred through the appropriate legislature.

30 June 2011

Embassy of China—Written evidence

1. General overview of China-UK development cooperation

China has been receiving development assistance from UK since late 1990's, after both governments signed the MOU on development cooperation. It is appreciated that the overall DFID-China development strategy is mainly focus on poverty reduction, in particular through achieving the Millennium Development Goals. Although DFID is not a large donor to China, but is one of the most prominent bilateral donors in the sector that DFID operate: Education, Health, HIV/AIDS and Water. DFID projects have contributed to national policy development in all those sectors. In recent years, China has established a series of policies in health, education and HIV/AIDS prevention. It is easy to find the principles of DFID's program in those new strategies and regulations.

Besides the contribution to China's overall policymaking process, DFID has also effectively targeted its support towards poor area of China, prioritizing interventions that specially address the needs of poor rural children, ethnic minorities and girls. In education sector, Chinese relevant authorities and DFID have jointly established the approach of demonstrating the effectiveness of innovative approaches at the micro-level, and then handling over such projects to Chinese authorities to scale up. This approach has achieved a real and positive impact on the Chinese education system and benefited (and will benefit) millions of children and communities.

Another show case for the effectiveness and sustainability of DFID China program is the joint DFID-International Labor Organization "Start and Improve Your Business" (SIYB) project. It has achieved a huge multiplier effect for their initial investment following Chinese government's expansion of the project from 14 initial cities to more than 100. It has become the systematic training programme which is financially supported and administrated by the local social protection authorities.

2. China's management of foreign aid

China's development in the modern age would have taken a different shape or pace without foreign aid.[83] On the other hand, foreign aid would not have played an effective role in China's development without the Chinese government leading and governing the entire process of aid projects.

In order to incorporate foreign aid fund into China's national development plan, the Chinese government offers foreign donors a list of national development priorities and projects so that both China and donors can work together to channel the limited aid funds into key development projects, and make the best use of aid funds. On the

[83] Deng Xiaoping said to World Bank President Robert McNamara in 1980: "Without the World Bank's help, China can definitively reach its own goals. With the World Bank's help, China will be able to develop at a faster pace". The International Bank for Reconstruction and Development/The World Bank: "China and the World Bank: A Partnership for Innovation", 2007

implementation level, China sets three criteria for project application: the project should be in accordance with China's long term national economic development policy; it should be coherent with China's long-term plan for poverty alleviation; and it should be relevant to the local economic development plan. With the new criteria, China has developed separate managerial agencies and methodologies for receiving aid and foreign direct investment.

China has not only channeled foreign aid toward building roads and markets, upgrading research and training, eliminating poverty, but also toward stimulating reform and change. The aid projects were often introduced to pioneer policy reorientation, to bring about fresh ideas, and to change the mindset in local society, thus pushing forward the transformation of government functions and the transfer of public financial resources toward social reform and development. After the mid-1980s, foreign aid funds as a proportion of foreign capital inflow decreased, but China's interests in working with donors in attracting knowledge, skills, and ideas have shown the slightest decline.

3. <u>Making donors successful in China</u>

The Chinese government and foreign donors in China all have an interest in, and responsibility for, the best use of scarce public funds. Both sides also have a need to measure their efficiency and to justify their activities. This makes the Chinese government and donors natural collaborators. With support and collaboration from relevant government authorities, foreign donors have a better chance of succeeding with their projects, and most donors are satisfied with their performance and achievements in China. This is proven by the higher success rate for development projects in China than elsewhere.

For example, in the course of cooperation with China, UNDP has respected the Chinese government's leading role in assistance activities, and has conducted development cooperation with the Chinese government in accordance with China's own development strategy. In order to synchronize China's "Five-Year Plan" with its aid project, UNDP formulates its Country Action Plan for China once every five years, sets priorities according to the central tasks specified in the Chinese government's "Five-Year Plan", and tailors its development assistance to China's actual situation. DFID shares similar principles as they launched "2006-2011 China Strategy" in order to cope with our 2006-2010 five-year plan.

While working closely with the Chinese government, donors enjoy the advantage of setting the rules and managing the process. By working with donor agencies, China has accumulated extensive managerial experiences and market skills. Moreover, donors have been duly respected in China as "teachers", and served as policy advisors for the Chinese leadership.

4. <u>Concluding Remarks on China's experience of receiving foreign aid</u>

The amount of aid to China is not significant in quantity, yet it generated remarkable effects. The main reason is that China maintained final responsibility and ownership of the development assistance. By managing development assistance, China has launched an incremental and peaceful development which is built upon digestion of others' experiences, while contributing to the general development practices of mankind.

30 June 2011

Christian Aid—Written evidence

1. Introduction

1.1 Christian Aid is a Christian organisation that insists the world can and must be swiftly changed to one where everyone can live a full life, free from poverty. We work globally in over 40 countries for profound change that eradicates the causes of poverty, striving to achieve equality, dignity and freedom for all, regardless of faith or nationality. We are part of a wider movement for social justice. We provide urgent, practical and effective assistance where need is great, tackling the effects of poverty as well as its root causes.

1.2 We welcome the opportunity to provide written evidence to the House of Lords Economic Committee on the Economic Impact and Effectiveness of Development Aid. We have focused this submission primarily on question 12: *'in what ways, if any, can the British Government improve the effectiveness of its development aid?'*. We have also covered questions 1, 2, 7, 9 and 10 in part. We are happy to provide further written and/ or oral evidence on any of the subjects covered in this submission via Melanie Ward, Senior UK Political Adviser.

2. Growth is not the only factor – poverty and inequality are vital

2.1 It is tempting to use economic growth as the benchmark for the impact and effectiveness of aid. While clearly important, there are broader human development factors which must be considered including health, education and inequality. National GDP growth does not automatically lead to meaningful development for all sectors of society, at both and economic and human levels. **The relationship between income poverty and growth is uncertain, and growth alone does not address inequality automatically.**[84]

2.2 For example, while India has been experiencing rapid economic growth, it has significant poverty and inequality. The new Oxford University and UNDP Multi-dimensional Poverty Index (MPI) uses indicators covering three aspects of poverty (education, health and living standard) to capture the extent and nature of poverty at the household level. It shows that 55% of the population, approximately 643 million people, suffer multiple deprivations. It further shows that there are more poor people in eight states in India than in the 26 poorest sub-Saharan African countries. When the vast Indian state of Madhya Pradesh, which has a population of 70 million, was compared with the Democratic Republic of the Congo, the two were found to have nearly identical levels of poverty[85]. **Severe poverty and inequality can remain in countries that have grown significantly overall, and aid should continue to address these issues in countries where the governments do not.**

3. The economic case for aid – aid works, and works in different ways

[84] *Poverty Over: We're All In This Together*, A Christian Aid Report, 2010 - http://www.christianaid.org.uk/images/were-all-in-this-together.pdf
[85] http://www.ophi.org.uk/wp-content/uploads/Country-Brief-India.pdf

3.1 Since the Marshall Plan was derided by Senator Dirksen as 'Operation Rat-Hole', to the recent theses on 'Dead Aid'[86] there has been a critical view on the impact of aid. This often uses broad brush analyses of aid to prove how aid has failed to have any meaningful economic impact. However such broad approaches often fall into the trap of assuming causal links without investigating further. While the development of Less Developed Countries. and especially Africa since decolonisation, has not been as hoped, the case that the poor performance is due to aid is far from proven.

3.2 A survey of 64 cross-country regressions on the link between aid and growth found that 38 showed a significant and positive relationship, 25 insignificant and only one a significantly negative relationship.[87] While, as discussed above, growth is not the only factor a positive relationship is clearly beneficial. The research on the link between aid and broader human development is much less extensive, but again there is evidence to suggest a positive impact on human development from aid focussed on it.[88]

3.3 Perception and expectation are both significant problems in assessing aid. While the sums being spent on aid currently are not insignificant, they do not compare to that spent on countries that have seen the most impressive development. The Marshall Plan is the classic example, where aid amounted to more than $200 per person per year in the benefiting countries. South Korea similarly received over $200 per person per year from the mid 1960s to mid 1990s and Botswana was receiving aid at over $150 per person per year in the two decades after independence when it had the highest average economic growth rate in the world. In contrast, aid per capita in Ethiopia had risen to $25 per person per year in 2010[89], and for all of Africa aid has averaged around $24 per person per year[90].

3.4 Further, despite much of the attention now being focussed on Africa, unsurprisingly as it is in the most need, historically this has not been the case. Asia has received more aid historically than Africa ($40bn more between 1960 and 2004) and it has only been recently that Africa has been seen as a significant focus[91]. Africa has also suffered more than other regions in fluctuations of aid spending, with an especially notable impact at the end of the cold war as aid volumes to Africa declined rapidly, such that only three countries in Africa were receiving more in aid in 1999 than in the late 1980s.[92] This decline in aid has led to higher poverty and made the Millennium Development Goals (MDGs) harder to achieve[93]. Further problems caused by unpredictable aid flows are well known, and there are currently clear concerns that budgetary issues amongst the major donors could precipitate a reduction in aid, as occurred in the 1990s. In this context, **legislation to ensure that the UK spends 0.7% of Gross National Income on Official Development Assistance would provide certainty to developing countries as to the UK's aid flows, as well as an example for the rest of the world to follow.**

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[86] Moyo, D (2009) *Dead Aid* London:Penguin
[87] Hansen, H and Tarp, F (2000) Aid Effectiveness Disputed. *Journal of International Development* 12(3) (p. 27 of UN report)
[88] See Gomanee, K, Morrissey, O, Mosely, P and Verschoor A (2005) Aid, Government Expenditure, and Aggregate Welfare. World Development 33(3) and Asiama, J and Quatery, P (2009) Foreign Aid and the Human Development Indicators in Sub-Saharan Africa. *Journal of Developing Societies* 25 (1).
[89] Barder, O (2010) An open letter to Aid Skeptics. *Development Aid* Spring 2010
[90] Economic Development in Africa: Doubling Aid, making the 'big push' work - UNCTAD2006 - http://www.unctad.org/en/docs/gdsafrica20061_en.pdf
[91] Ibid
[92] Ibid, see also McGillivray, M (2005) Is Aid Effective accessed at http://www.oecd.org/dataoecd/18/39/34353462.pdf
[93] Micillivary, op cit

3.5 The purposes of aid are also varied but they can roughly be broken into three main areas:

- Humanitarian aid: which this committee is not looking at, but which does amount to 8.2% of the OECD member's aid spending (up from 1.8% in 1988), and 8.9% of DFID's budget[94].
- Short-impact aid: aid which can be reasonably expected to have a measurable economic impact in a short period of time, e.g. budget and balance of payments support, investments in infrastructure and aid for productive sectors. Currently 27.2% of OECD members and DFIDs spending
- Long-term aid: aid whose impact will not be realised in a short period of time, and so is inherently more difficult to assess due to the role of other factors over the time period. For example, with education, any impact from an increase in spending in education will not be properly seen in terms of economic statistics for 15-20 years, but other factors will also effect whether economic impacts can be rightly or wrongly attributed to the increased spending in education. Currently this accounts for 40.7% of OECD members', or 42.1% of DFID's[95] spending.

3.6 This is significant as the trend recently has been to focus more on what would be deemed long-term aid (40.7% in 2008-9 as against 24.8% in 1988-9), which many of the MDGs are geared towards. The United Nations[96] (amongst others) finds that this may explain why debates about aid effectiveness have recently become increasingly strident. An expectation gap has developed, as results are being expected earlier than is possible given the long-term nature of much of recent development spending.

3.7 When short-impact aid is assessed by itself there is evidence to say that it is indeed effective to the degree that a $1 increase in short-term aid raises output (and income) by $8[97]. Whilst assessing the impact of long-term aid is challenging, research into this area does provide evidence that, on balance, aid continues to have long-term benefits.[98]

3.8 While the evidence suggests that aid has had a positive impact, not all aid has been effective. **The general trend is that aid has a positive impact on economic growth and human development** and that when assessing aid it is necessary to disaggregate other factors. However, there are ways in which aid can be improved.

4. Traditional Aid flows and other actors – transparency is vital; supporting not substituting

4.1 The changing nature of the sectoral focus of development assistance over time does pose questions with regard to the balance of aid being provided to developing countries. This is not to give prescriptions on the best ratio of short/long impact aid. Each country will have different needs and so the balance must be determined by the circumstances. However, the gradual shift to long-term aid by OECD members must

94 Statistics from OECD - http://www.oecd.org/document/16/0,3746,en_2649_34447_42396496_1_1_1_1,00.html
95 Ibid – 23.9% of OECD and 21.8% of DFID funding is attributed as 'other' and so not included in analysis.
96 Economic Development in Africa, op cit
97 Clemens, Radelet and Bhavnani (2004) Counting Chickens when they hatch: The short-term effect of aid on growth *Centre for Global Development* WP44.
98 Reddy, S and Minoiu, C (2006) Development Aid and Economic Growth: A Positive Long-Run Relation http://www.un.org/esa/policy/backgroundpapers/odaandgrowth.pdf

be the response to a need expressed by developing countries, rather than due to trends in thinking in donor countries which are divorced from realities on the ground.

4.2 It may be that the increased engagement of emerging powers in Africa provides a way to balance (long-term) social and (short-impact) infrastructure focussed aid in a different way. China's assistance has been overwhelmingly focussed on infrastructure for example.[99] However, China is providing much of its assistance in the form of loans, when the evidence suggests that debt repayments have a negative economic impact in developing countries.[100] There are clear concerns that new debts built up with emerging powers could have a negative impact on developing countries. **To ensure compatibility and effectiveness of aid and other support from traditional and non-traditional donors, greater transparency is needed in the terms of agreements between developing countries and donors and businesses. Engagement at the G20 level to build agreement on international transparency standards is one way to take this forward.**

4.3 The significance of the distinction between growth and the broader notion of human development is clear when comparing the impact of aid and foreign direct investment (FDI) on development. Both aid and FDI could be reasonably assumed theoretically to have the potential to improve growth and, by extension, human development. However, aid is found to have a positive impact on growth and human development whereas FDI has at best no impact on growth and a negative impact on human development in the least developed countries.[101] This makes clear that **FDI cannot be used as a substitute for aid.** This is not to say there is no role for the Foreign Direct Investment in development, but it needs to be carefully considered alongside the institutional factors which will enable the poor to benefit from such investment.

5. Improving aid effectiveness (A) - Focus on Development not Geopolitics

The question remains that if economic research suggests that aid is effective, why do some believe that it has failed?

5.1 The fact that not all aid has been aimed at development is perhaps the first reason; aid which has a primary purpose other than development is unlikely to have the same impact of that which is focussed entirely on development. One of the biggest criticisms of aid to Africa during the period from decolonisation to the end of the cold war was that much of it was directed to fighting the cold war by proxy, rather than addressing development concerns. The most recent study[102] that has tried to disaggregate developmental aid (i.e. aid for purely developmental reasons) from geopolitical aid (i.e. aid that has been motivated by donor political concerns) finds that there is a very strong correlation between developmental aid and economic growth, and a negative correlation between geopolitical aid and growth. This provides a clear message that seeking to let UK security concerns direct aid spending is unlikely to be effective. Just as Christian Aid seeks to provide assistance wherever there is need, regardless of faith or nationality, so the **UK government should ensure aid is focussed on development and not on domestic security concerns or geopolitical aims.**

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99 See 2011 Africa Economic Outlook - http://www.africaneconomicoutlook.org/en/in-depth/africa-and-its-emerging-partners/new-and-old-partners-help-africa-in-complementary-ways/

100 Clemens, ibid

101 Kosack, S and Tobin, J (2006) Funding Self-Sustaining Development: The Role of Aid, FDI and Government in Economic Success.

102 Reddy S and Minois C (2006). Development Aid and Economic Growth: a positive Long-Run Relation. New York: United Nations, DESA

6. Improving Aid Effectiveness (B) - Addressing Capital Flight

6.1 The other significant issue is that **while aid provides a flow of resources into developing countries there is a much greater outflow of resources through illicit capital flight**. Given the UK government's focus on value for money for British taxpayers, it makes little sense to increase the aid budget yet do nothing to stop vast revenues from being lost to developing countries each year.

6.2 Global Financial Integrity estimates (conservatively) that Africa lost $854 billion in illicit capital flight between 1970-2008[103], twice what Africa received in development assistance - this makes Africa a net creditor to the world. The problem is growing rapidly, increasing by an average of 11.9% per year. Given this situation, it is hardly surprising that development is difficult for Africa. It seems difficult to ask questions about the ability of developing countries to absorb greater amounts of aid when their economies as a whole are simply not receiving the huge influx of resources that such concerns are predicated on.

6.3 Corruption on the part of those receiving aid is certainly a part of the problem, but given the losses are more than aid received, it is clearly not the only problem. Indeed, Global Financial Integrity finds that globally just 3% of capital flight is from bribery and theft by government officials[104].

6.4 Christian Aid's own research, looking just at transfer mispricing and false invoicing estimates that **developing countries lose $160 billion a year in lost tax revenue**, some one and a half times the global aid budget.[105]

6.5 That such capital flight and tax avoidance is possible is due to both corruption and lack of capacity within developing countries but also, significantly, through utilising the willingness and ability of the global financial system to facilitate such processes. Tax havens are the prominent example of this facilitation; by providing financial secrecy, they facilitate the movement of capital abroad making it difficult for tax administrations to trace the transactions. There is neither the robustness of checks at the time of transaction to ensure transfers are legitimate nor the ability for interested parties to perform checks afterwards to trace the flows out of their country. In addition, the weakness and limited coverage of information exchange treaties between developing countries and tax havens mean that the risk of a tax evader being challenged is limited.

6.6 Furthermore, tax havens are used by some multinational companies to shift profits from where they are made to where they will incur low levels of tax. Under-resourced revenue authorities in developing countries find it difficult to track such abuses. If developing countries had reports of profits and activities in each country where multinationals were based, then they would be in a better position to target their resources towards high risk companies.

6.7 **A key way to ensure that aid is made more effective is to ensure that aid functions as additional resources to the recipient country economy.** This

[103] http://www.gfip.org/storage/gfip/documents/reports/gfi_africareport_web.pdf
[104] Ibid
[105] Death and Taxes, A Christian Aid Report 2008 - http://www.christianaid.org.uk/images/deathandtaxes.pdf

comes through targeting the direct corruption of aid. It also comes through ensuring that aid is not tied, and through being more honest about the scale of aid flows. While debt relief has been necessary, it does not equate to resources entering into an economy and so including it in aid statistics paints a false impression, compounding the expectation issue highlighted above.

6.8 **Just as significant is ensuring that other resources stay in the economy, and so aid is not just making up for losses elsewhere, but is functioning as an extra resource into the economy. This means tackling capital flight.**

6.9 **The UK government can increase the economic impact and improve the effectiveness of its aid by combining aid spending with actions to combat losses of capital from elsewhere in the economy:**

- **Providing support for capacity building in domestic resource mobilisation - DFID is already doing this**
- **Assessing the impact of planned changes to the taxation of UK-based multinationals that may lead to an increase in tax avoidance overseas, such as the proposed reforms to Controlled Foreign Companies rules contained in the current Finance Bill**
- **Leading global action at the G20 to:**
    - **Ensuring multinational companies report on their activities country-by-country**
    - **Support information exchange agreements to end tax haven secrecy**

7. Citizens impose the best Conditionality

7.1 Improving domestic resource mobilisation can also help address the issue of donor conditionality. There are divergent views on the impact of quality of policy regime on the impact of aid on growth.[106] What has been largely agreed on is that the strict policy proscriptions enforced by the International Financial Institutions in the Structural Adjustment Programmes of the 1980s and 90s were misplaced. As aid becomes a more significant source of government revenue, there is a risk that governments become less accountable to their citizens and more focussed on satisfying donors. Increased tax revenues can avoid the absorption concerns associated with large aid inflows.

7.2 As a government increases its own revenue-raising ability, it builds capacity and also increases the link between state and society. Research suggests a positive link between growing tax revenues and improved governance[107]**.** If governments are dependent on taxes they are dependent on the prosperity of their citizens who pay the taxes, and will therefore be more motivated towards policies that foster prosperity. Dependence on taxes requires the bureaucracy to develop, and improvements in the revenue service can spill over to the rest of the bureaucracy. Perhaps most significantly, taxation engages citizens in politics. Those who are paying taxes have a vested interest in how

[106] See McGillivray op cit p. 3 for a summary of the literature
[107] Death and Taxes, A Christian Aid Report 2008 - http://www.christianaid.org.uk/images/deathandtaxes.pdf

they are spent, and so developing the tax system can help make the state more responsive to its citizens and improve its ability to shape its own development path.

7.3 Increased domestic revenue mobilisation through developing the link between state and society can make citizens more engaged in development spending.

8. MDGs and the need to address the system, not only the symptoms

8.1 The Millennium Development Goals have driven significant progress and have raised the profile of international development which was greatly needed after the fall in aid in the 1990s. However they have also underperformed, primarily due to flaws in the understanding of poverty, and seeking to treat the symptoms of poverty only, rather than including the systemic and structural causes.[108] This meant that the ambition of the Millennium Declaration was lost and poor countries were told what their priorities should be.

8.2 Christian Aid believes that a global framework has the potential to be effective, as indeed the MDGs have been, but that flaws in such a framework will also have global consequences. This makes it vital that the post 2015 successor to the MDGs is considerably different. **The successor to the MDGs must take account of inequality, sustainability and active citizen participation to a much greater degree. It must be developed in a more open, transparent and inclusive way and insofar as it imposes conditions they should apply to donors as well as recipients of aid.**

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[108] We're all in this together, A Christian Aid report , 2010 http://www.christianaid.org.uk/images/were-all-in-this-together.pdf

Christian Aid, Practical Action, Save the Children and Oxfam—Oral evidence (QQ 206-251)

Transcript to be found under Practical Action

Christian Aid—Supplementary written evidence

A note to the House of Lords Economic Affairs Committee:
Research into FDI, economic growth and human development

In Christian Aid's submission to the House of Lords Economic Affairs Committee on aid, we noted that "aid is found to have a positive impact on growth and human development whereas FDI [foreign direct investment] has at best no impact on growth and a negative impact on human development in the least developed countries." As stated in our submission, this finding draws on academic research published by Kosack & Tobin (2006).

We went to draw the following conclusions for policy: "This makes clear that FDI cannot be used as a substitute for aid. This is not to say there is no role for [FDI] in development, but it needs to be carefully considered alongside the institutional factors which will enable the poor to benefit from such investment."

During oral evidence on 13 September, the Committee quite reasonably sought confirmation that the evidence base for this strong claim was broader than this particular paper (of which the authors are political scientists, then at Yale University, rather than economists).

We therefore felt it might be useful to provide to the Committee this additional written note, summarising some of the key findings from the more technically accomplished economics literature on the relationship between FDI and economic growth in developing countries, and between FDI and human development.

FDI and economic growth

This was the element of the submission to which committee members reacted with most scepticism. This is unsurprising, in light of the recognised need for financial resources to support development, and the importance of investment *in general* in promoting economic growth. In addition, earlier research reviews such as Lim (2001) and Hansen & Rand (2006) have indicated a rough consensus in favour of positive economic growth effects of FDI in developing countries.

Even this earlier literature, however, contained considerable cross-country evidence against growth benefits. Borensztein, de Gregorio & Lee (1998) find a positive effect overall, but show that it reverses for countries with low levels of human capital so that FDI here actually reduces growth. Schneider (2005) focuses on the role of intellectual property rights, and – allowing for this – is unable to discern a significant growth impact of FDI inflows.

Research focusing on technological spillovers (with FDI hypothesised to drive growth via productivity gains) is similarly inconclusive, e.g. Blomström & Kokko (1998). The meta-analysis of Görg & Strobl (2001) raises substantive questions over the robustness of existing positive results, including some evidence of publication bias (reflecting the tendency of journals to publish – and hence authors to present – results that are statistically significant, rather than those that offer no such apparent certainty). A later paper by Görg & Greenaway (2004) offers a damning critique, showing that only six out of 25 studies they could find using appropriate data and techniques showed benefits. Not one of these applied to developing countries; in contrast, the one clear result that did apply to a developing country showed *negative* effects (Venezuela – Aitken & Harrison, 1999). Finally, Blonigen & Wang (2005) demonstrated the misleading results that could be obtained by pooling data for developed and developing countries.

By the time Beugelsdijk et al. (2008) conducted their analysis emphasising differences between vertical and horizontal FDI (the latter more positive for growth in developed countries), they expressed the developing country result only as an aside: "In line with existing literature, we find no significant effects of horizontal or vertical FDI in developing countries" (p.452).

In the same year, Herzer et al. (2008) published perhaps the most damning study of all for what they refer to as 'the widespread belief that FDI generally has a positive impact on economic growth in developing countries'. The summary of their findings is worth quoting at length (p.795):

> [First], we show that existing cross-country and panel studies, as well as time series analyses suffer from several econometric problems that question the reliability of their findings. Second, this paper then empirically re-examines the impact of FDI on growth in developing countries in a country-by-country time series approach. Our main contributions are that we control for heterogeneity in the FDI-growth relationship between different countries, use Granger causality tests to investigate whether FDI actually leads to economic growth and not vice versa, and allow for both long-run relationships between FDI and GDP in levels and short-run relationships between FDI and GDP in first differences. Moreover, a battery of cointegration tests is used to check the robustness of our results.
>
> Our main finding is that in only four out of the 28 countries in our sample, FDI contributes to long-run growth. Yet, in these countries, growth and FDI are self-reinforcing. For one country (Ecuador), it is indeed found that FDI exerts an independent long-run effect on GDP, but this long-run growth effect is negative. All in all, the results suggest that FDI does not have a generally positive impact on economic growth in developing countries and that there is also no clear association between the growth impact of FDI and the level of per capita income, the level of education, the degree of openness, and the level of financial market development.

In short, the authors (who are leading economists) find previous studies are not valid, and with a superior methodology show there is no evidence of independent, positive, long-run effects of FDI on growth in developing countries; and limited evidence of negative effects.

We believe, therefore, that the evidence supporting our statement that "FDI has at best no impact on growth in the least developed countries" is persuasive.

Current research questions

More recent research has continued the search for growth benefits of FDI, emphasising the initial conditions – that is, hypotheses to the effect that 'only when a country has X in place will FDI have growth benefits'. Perhaps the most promising efforts focus in two main areas of initial conditions: the extent of financial market development, and the strength of a country's institutions.

In the first of these, Azman-Saini *et al.* (2010) find evidence of a threshold effect – a level of financial market development above but not below which growth benefits of FDI can be discerned. Lee & Chang (2009) follow Herzer et al. (2008) in using cointegration analysis, but include financial development with FDI and growth to assess the inter-relationships and causality at play across the three. They find positive effects of FDI on growth, given sufficient financial development, although they note that the growth impacts of financial development outweigh those of FDI.

Finally, in the second focus area, Alguacil et al. (2011) present findings that support emphasis on "the macroeconomic and institutional environment. Thus, host country governments should develop a set of policies that are not only focused on inward FDI promotion but also on the improvement of their political and economic framework" (p.481).

As per the evidence discussed with the Committee on 13 September, there are serious doubts as to the benefits that can be expected from FDI into those countries with the weakest institutions (which more or less by definition have the lowest level of financial development). The FDI in question is likely to be in the extractive industries, and likely to rely primarily on imported capital goods and only low-skilled local labour. Corruption is common in such situations, and overall it should be unsurprising if ultimate economic benefits to the country are hard to trace.

An interesting new development in the research is that of Perez et al. (2011). These authors (from US and Canadian universities, and the World Trade Organisation) assess the extent of illicit financial flows – corrupt money – in outward FDI from transition economies: "We estimate that 6–10% of total FDI outflows and over 20% of FDI to money-laundering countries from our sample were made to facilitate illicit money flows" (p.1); and "We have shown that the volume and country of destination of bilateral FDI flows from our sample of transition economies to a broad sample of host countries are driven, in part, by non-economic motivations such as the desire to facilitate illegal capital flight and money laundering. By means of a widely-used model of bilateral FDI flows, we show that in average 29% percent of total FDI is directed toward countries that are money laundering centers and that, of the FDI going to these countries, about 20% is motivated by the desire to facilitate illicit money flows." (p.18).

While these results do not directly shed light on the reasons why FDI into developing countries do not yield growth benefits, they do suggest a possible research question. Analysis of bilateral trade and financial flows (e.g. Cobham, 2012 forthcoming) shows that developing countries are typically quite highly exposed to secrecy jurisdictions (more commonly called 'tax havens', and similar to Perez et al.'s (2011) 'money-laundering centers'). Anecdotal and aggregate evidence also shows such jurisdictions being used for 'round-tripping' FDI – domestic investors taking money out of the country in order to return it and have their investments treated (beneficially) as FDI. The roles of Mauritius, with regard to India, and the British Virgin Islands, with regard to China, are most well-known in this regard.

The question this raises is whether there are systematic differences in the benefits for developing countries of FDI (and similarly of trade and other financial flows), according to the bilateral partner. In particular, we hypothesise that the benefits will be lower, and perhaps negative, when the bilateral partner is characterised by greater secrecy, because this is likely to create greater opportunities to illicitly strip the benefits from the developing country in question. Christian Aid plan to create a dataset of bilateral flow relationships with a view to testing this hypothesis.

FDI and human development

The question of human development impacts of FDI is relatively under-researched compared to that of the growth impact, in what sadly reflects a consistent pattern in economic analysis of financial flows in development (see e.g. the survey of capital account liberalisation studies in Cobham, 2002).

The most recent, comprehensive treatment of the question is that of Reiter & Steensma (December, 2010). They test three hypotheses in relation to the impact on the FDI-human development relationship of government policies that restrict FDI (ideally into sectors that will provide greater benefit), and find as follows (pp.1686-1688, emphasis added):

> In hypothesis 1, we suggest that FDI flow will have a stronger positive (or weaker negative) influence on improvements in human development when the country has FDI policies that restrict foreign investors from entering some sectors. […] Based on the empirical model, *an increase in FDI flow from the sample mean to one standard deviation above the mean decreased year-to-year improvement in HDI [the Human Development Index] by 11%* when there are no restrictions. However, when there are FDI restrictions, the same increase in FDI flow had virtually no influence on HDI improvement. Thus, our results suggest that restrictions on FDI buffer against the negative aspects of foreign direct investment with regard to human development.
> In hypothesis 2, we suggest that FDI flow will have a stronger positive (or weaker negative) influence on human development when the country has discriminatory policies toward foreign investors. […] Based on the empirical model, *an increase in FDI flow from the sample mean to one standard deviation above the mean decreased year-to-year improvement in HDI by 3%* when there are no discriminatory policies. However, when there are discriminatory policies, the same increase in FDI flow had no influence on HDI improvement. We find somewhat similar support regarding discriminatory policies when considering their influence on life expectancy.
> In hypothesis 3, we suggest that FDI flow will have a stronger positive (or weaker negative) influence on the improvement in human development when the corruption of the country is limited. […] Based on the empirical model, *an increase in FDI flow from the sample mean to one standard deviation above the mean decreased HDI improvement by 7%* when corruption was high (i.e., corruption is greater than the mean by one standard deviation). In contrast, an increase in FDI flow from the sample mean to one standard deviation above the mean increased HDI improvement by 3% when corruption was low (i.e., corruption is less than the mean by one standard deviation). Somewhat similar results are found for improvements in life expectancy and adult literacy."

Broadly, the results indicate that in the absence of guiding policy, and/or in the presence of corruption, FDI inflows are associated with deteriorations in the human development index. Where FDI is restricted by policy, the associated human development impact is neutral; and where corruption is low, FDI can be associated with positive improvements in the HDI.

Since the HDI is a composite index, the confirmatory results on individual components such as life expectancy and adult literacy are reassuring. Unfortunately, the literature is limited in detailed analysis of individual aspects of human development. One recent working paper (Mughal & Vechiu, 2011) does focus on educational impacts of FDI.

The authors respond to a broad literature that has assessed the importance of initial levels of human capital (measured via educational attainment) in determining whether countries can benefit from greater international economic integration. This work includes Borensztein et al. (1998), who find that the benefits of FDI depend on countries meeting a threshold level with respect to secondary education.

Mughal & Vechiu (2011), in contrast, consider the direct impact of FDI on educational attainment. They find "a non-negligible negative impact of FDIs on tertiary enrolment as well as on total population with secondary or tertiary education. We find no evidence of a significant impact on secondary enrolment. A 1% increase in FDIs (FDI ratio) may lead to about 0.03-0.04% (0.02-0.04%) decrease in tertiary enrolment and to a 0.01% decrease in total population with secondary or tertiary education" (p.13).

Their explanation, in line with Beugelsdijk et al. (2008), is that the short-term effects at least of lower value-added FDI may be to promote the type of low-skilled labour this depends upon, which may discourage investment (by state or by individuals) in higher levels of education.

As of now, the evidence is at least strong enough that we should have a presumption that in the least developed countries, where limited policy capacity too often combines with broader governance issues, FDI will tend to be limited to the extractive industries and little beyond, and is likely to be associated with a deterioration in human development outcomes. Clearly there is a substantial research agenda here, and a better understanding of the detailed channels of impact is needed.

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As we said in our submission, "FDI cannot be used as a substitute for aid. This is not to say there is no role for [FDI] in development, but it needs to be carefully considered alongside the institutional factors which will enable the poor to benefit from such investment." The evidence is strongly suggestive of the hypotheses that FDI has no systematic economic growth benefits, and potentially systematic human development costs, in the least developed countries. Christian Aid continues to research into the underlying causes of these apparently counter-intuitive findings, including a particular hypothesis about the potential damaging effect of the mediation of economic and financial flows through secrecy jurisdictions rather than direct from the investing country.

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Sir Edward Clay—Written evidence

1. I am a former diplomat. I was head of mission in Uganda (1993–7) (and non-resident ambassador to Rwanda and Burundi for parts of that period), Cyprus (1999-2001) and Kenya (2001–5). I was Director of Public Services in the FCO from 1997-9.

I have worked over many years with colleagues in DfID and NGOs. I am now involved as a trustee or otherwise with several NGOs. My comments reflect my personal experience.

…………………………..

2. I should like to comment on points 7, 10 and 12 of the list of questions your Committee has identified as of particular interest in your enquiry. I hope my response may also be relevant to other points, particularly 4 and 5.

Point 7. *How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?*

3. The recent discussion provoked by Dr Fox's leaked letter to the Prime Minister in which he opposed enshrining the UK's commitment to this target in law was unsatisfying. First, defence and development are not mortal enemies. Both are crucial to our international posture and national security. Second, while senior officers and the heads of some of the over-40 blue-chip NGOs with Partnership Programme Agreements (PPAs) were prominent in the debate, we heard nothing from the much more aid-dependent of DfID's clients, like the World Bank and European Commission (taking all together over one third of DfID's budget), nor the governments in receipt of Budgetary Support.

4. Most striking was the absence of a voice from a very poor citizen of an aid-recipient country. Most official aid goes to and through governments. But media information in donor countries understandably uses individuals to tell the story of the transformative value of an aid project. Such testimonies are persuasive, but don't cover three questions: if you had had a choice, is this what you would have wanted most to change in your life? Has your own government given you full value for the aid money granted? Does aid affect fairness and inequality?

5. I support giving more development assistance but believe the 0.7% commitment is inappropriate and out of date. Since the target was first declared in 1970, the amount of aid delivered has increased enormously. The character of aid and of its recipients has changed. Our understanding of what makes or keeps countries poor has expanded, particularly in respect of conflict and its many facets.

6. It is not at all clear why 0.7% should have its special status now: it is most unlikely that the requirement for development assistance from rich countries, calculated on a variety of alternative measures, would neatly coincide with 0.7% of their GDPs. Having such a target may obscure the need to re-examine our consideration of whom and how we aid in the interest of a crudely quantitative approach. We might need more; or less; and the requirement may rise and fall in respect of the total as it does in respect of individual country programmes.

7. For the UK, with a strong aid department, why do we give aid? What place has it in the international posture we want to adopt? The International Development Assistance Act planted DfID's standard firmly on the ground of aid for aid's sake. In the context of the recent previous history, that was and is understandable. But a big spending department cannot be indifferent to the other things HMG must achieve in its international policies. The resources voted to DfID in present circumstances look disproportionate when set against other instruments of policy which have proved useful before and are being squeezed. Of course, we need to replace and adapt these to respond to new and different sorts of challenges: but while the rest of Whitehall is doing so, and with less, DfID ploughs its own uniquely well-funded furrow. It pursues poverty reduction, moreover, in places where the roof is falling in.

8. Governments must be held accountable for the way they raise and spend taxes, including in the area of overseas activity. Aid is invisible to most voters and the problems over assessing its effectiveness are many. The rapid rise in funding of DfID has increased the pressure on the department to spend, while its capacity to monitor has not expanded commensurately. Hence the partnership (PPA) NGOs above: a quick way of disbursing a lot of money. But the share of NGOs in implementing DfID's programmes is nothing compared to the huge sums delegated to multilateral agencies. Some of these grants are fixed by Agreement, and are much less open to rigorous scrutiny by our mechanisms than other sectors of UK government expenditure.

9. Total Budgetary Support to poor governments is slightly more than the value of DfID funding given to NGOs. Budgetary Support is another way of minimising transaction costs to DfID and spending a lot quickly. But it is vulnerable to criticism because it goes beyond ordinary oversight in the UK; and it is doubtful that oversight is effective when it gets into recipient treasuries in some poor countries. The danger in this is not mainly that aid funds are misappropriated. That can happen, but more importantly, aid creates headroom for national treasuries to be robbed. That is, recipient governments may misappropriate their own taxpayers' resources while the expectation of aid still gives them resources to sustain domestic development programmes. That should worry donors, as it should outrage citizens.

10. Experience accordingly suggests that the 0.7% target will both sharply increase the amount of money DfID must disburse to meet its legal obligation to spend, and aggravate its difficulties in ensuring it is well spent. It will overstretch the absorptive capacity of many poor countries with weak administrations: it is observable each year how much aid voted to particular programmes is not spent.

11. For UK taxpayers, the 0.7% target means a part of our taxes is committed for ever, without tight annual scrutiny or renewal of the sort given to other government programmes. In removing the very large sum (more than we spend on policing or the Olympics, a bit less than we give to charity, more than the UN spends on global peacekeeping) devoted to aid from the discretionary area of its activity, the government is tying its hands. It is also removing from taxpayers and electors the right to make a judgement on its stewardship on aid. It reinforces a quantitative approach to aid, measuring activity, instead of properly assessing what outcomes have been useful. It should worry us if the 0.7% target becomes so unpopular in the UK that it reduces public support for aid or reduces the revenues of NGOs from their own fundraising (cf the government's exhortations on voluntary giving).

Point 10. How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

12. I think there has been an improvement between the departments concerned in forging a better and an inter-departmental approach to conflict. Development assistance, however, still finds it difficult to help with some critical security issues of the following longer-term kind, which arise in states which have failed, or might:

- Criminality which might derive from social causes like youth unemployment and could develop into political or other more recognisable security phenomena. The current *World Development Report* said:

  "one in four people on the planet, more than 1.5 billion, live in fragile and conflict-affected states or in countries with very high levels of criminal violence.…….But because of the success in reducing interstate war, the remaining forms of conflict and violence do not fit neatly either into "war" or "peace," or into "criminal violence" or "political violence." "

  Where criminality and politics overlap, governments may be exceedingly sensitive to outside interference and frighten donors off. Social alienation causing conflict and criminality can lead to conflict becoming political, cf the Mungiki and other ethnic-based gangs in Kenya and their role in later post-election violence. We have no clear policy in response to these metamorphic conflicts.

- The forces of law and order can be so weakened and corrupted by the institutional failures which afflict states with chronically bad governance that they fail to provide their own citizens with proper security. How do we assist to improve matters without condoning, for example, bad behaviour by a demoralised police, or failings by an under-resourced prison system, or injustice at the hands of a corrupt judiciary? If we decide to get involved in helping put things right, can we effectively insist upon better governance in these sensitive areas? Any government – perhaps particularly a bad government - will keep close control on what is done and what outsiders try to do. They are in a much stronger position to control developments than donors.

- In Uganda in May, we have seen how a police service improved – with our help – in the 1990s has since turned into the strong, even forceful arm of the administration. How do we resolve the dilemma of wanting states to have effective structures to provide security to their own citizens without giving governments the means to clobber them? We saw a similar, even more ugly demonstration of the phenomenon in Kenya following the flawed election at the end of 2007.

- Donor governments have had much sharper reasons in the last decade for wanting poor countries to have effective forces of law and order so that they can be effective partners in international action against, for example, international crime (drugs and people-trafficking) and terrorism. The dilemma described above reappears in acute form: how do we help poor countries become good allies in common causes which affect directly our own interests, without putting into the hands of bad or weak leaderships the instruments of repression? Indeed, do the interests we want to promote or defend, impossibly overstretch our poorer partners whose help we need? How can we best protect our interests while helping weak states develop sound institutions and increase their people's welfare?

13. In Kenya, the corruption of institutions during the last Moi and first Kibaki governments has arguably been worst in the security sector. Arguments of 'national security' were deployed to protect proper scrutiny of budgets, while senior people were too busy 'eating' to do their jobs. Defence contracts have repeatedly been the source of unease and embarrassment when details emerged by accident. All the main security organisations, with huge and unaccountable budgets, were grouped under the Office of the President. The corruption itself was serious; the damage to Kenya's ability to function properly in the security sector was even more serious. The worst damage is at the top. The then-Chief of Police is now wanted in the International Criminal Court in connection with the police's behaviour during the post-election violence of 2007-8.

14. Perhaps at least part of the answer is to be more insistent upon a contract on governance between governments that give development assistance and governments which receive it. It may be necessary to attach specific and rigorous conditionalities on governance to individual programmes. Assistance, if it is to be effective, needs to go beyond DfID's remit.

Point 12. In what ways, if any, can the British government improve the effectiveness of its development aid?

15. Poor governance is a common cause of the failure of development assistance to achieve its objectives. Many of the world's problems can be attributed to corruption. Not always: some countries with sub-optimal governance make good progress and achieve high economic growth and improvements in welfare. But it is, I believe, fair to say that chronic poverty and, above all, deepening inequality cannot be overcome without confronting corruption in its many forms and recognising the debilitating effects it has on the institutions of a state. Those effects include obstacles to realising the potential for private direct investment as well as the proper delivery by governments of services to its citizens. Our development assistance programmes play a valuable role in both those areas; but they are less effective in tackling the underlying rot. Failing states will not develop successfully.

16. Part of the problem is that our aid programmes can breed in us, the donors, a kind of dependency: we risk being in thrall to recipient governments. It was understandable that in the 1990s we felt a surge of hope with the so-called new generation of African leaders who seemed to have the resolve and approach to pull their wrecked countries back together. We have been committed deeply to them. We quickly made clear our backing for what appeared to be a reformist government elected in Kenya in 2002. We had likewise welcomed the opportunities for reform presented by the end of the regimes which had subsisted since Independence in countries like Tanzania, Malawi and Zambia. This commitment to countries even extended to a personal bond of regard on the part of our ministers for some of their new leaders.

17. But as these regimes have developed their darker side, we seem too ready to indulge them; and unable or unwilling to extend or exert the influence which we have over social and educational programmes to the more sensitive aspects of the way leaders govern. Our aid programme should strengthen our ability to intervene and stiffen our resolve to do so.

We are, after all, stakeholders in the government's successes – and, though we may not like it, we become associated with their excesses or failures.

18. The horror of Rwanda in 1994 showed the risks of ignoring early symptoms of bad governance. They might presage worse developments. The earlier role of Belgium and latterly of France in Rwanda before 1994 is a warning of how unstinting support can make a partner-government complicit when things get out of hand. Rwandan governments had after all been persecuting the minority for over 30 years before the genocide. Some indulgent outsiders saw the early pogroms as the growing pains of social democracy.

19. I remember in the mid-1990s joining the World Bank and other donors to challenge falsification and concealment in the Ugandan defence budget. The Bank was certainly reluctant then to interfere in the sensitive area of defence. As a group our approach was arguably too timorous, considering how much we contributed to Uganda's budget (as we still do). It was, after all, unprecedented (it features in a fly-on-the-wall documentary I believe the Bank still use for training). But events proved our suspicions were well-grounded, even if we lacked at the time sufficient evidence and resolve to press the matter. Later conflicts in the Great Lakes demonstrated Uganda's ability and will to make mischief. Now we see that very poor country equipping itself with state-of-the-art military aircraft, for uncertain purposes. They have conjured up resources for these equipments while their old aircraft lie mostly neglected and unserviceable, and the government relies on aid for important social programmes.

20. In Kenya, the defining character of politics had for long been corruption. This had infected every institution of the state. For many years, donors called for meaningful action against it. It was widely known about by the people, who recognised some of its pernicious consequences but felt powerless. The government of President Kibaki promised to slay the dragon. It not only failed, but fed the beast.

21. In 2004, I believed that, having ample evidence, we ought to help express our indignation, as long-standing partners of Kenya, that the leaders to whom we were so deeply committed in our aid programmes were implicated in robbing the public purse. In addition, it was clear that Kenya's leaders were so mired in their self-enrichment that the government was failing to meet its own people's basic expectations for peace and security, and other services. Kenya was also an unreliable partner in international matters, including efforts against terrorism – from which they had of course already suffered grievously.

22. DfID's reaction to the anti-corruption campaign betrayed nervousness that it might threaten their programmes and relationships with key ministers. DfID also led the pack in 2007, after my retirement - when I criticised the last government's decision to call off the SFO's inquiries into BAe Systems' Saudi business as both hypocritical and damaging. That decision contradicted our long-standing call for African countries to uphold the Rule of Law and due process as part of our governance agenda. Michela Wrong's book *It's Our Turn To Eat* describes more fully DfID's indignation at the effect of disclosures by John Githongo, the self-exiled anti-corruption official President Kibaki had appointed and then betrayed.

23. When I have challenged DfID's continuing assistance to the Kenyan government, and their association with some suspect individuals, the stock answer has been that their investment in education and the fact that over a million additional children had been admitted to primary school overrode any serious reservations they might have about the

senior Kenyans they worked with. But of the top heads that rolled as a result of the outcry over corruption I had helped stimulate in 2004, three were key ministers in our bilateral relationship. Thus, the good that our aid has done was tainted by association of British support with some seriously bad hats. It was not clear in 2004 that Kenya was so near failing as a state; it nearly collapsed four years later under the weight of its leaders' unscrupulous rivalry and cupidity.

24. Interventions through conditionalities (your question 5) do not work, according to DfID's analysis. They certainly acquired a very bad name with the aid community and recipients when they were applied, because they were so inconvenient and rendered aid such a stop-start process. But we cannot just pretend we have no leverage. Eighteen months ago, DfID for the first time suspended aid to the Ministry of Education because of fraud in its expenditure. I do not think it has yet produced the missing money; but the action was a severe shock to Kenya, and felt right at the top.

25. When British aid seems to support governments or individual leaders whose character becomes quite other than what we hoped or expected, we risk being tarred with the regime's brush. It is very hard to make such judgements, but there must be red lines beyond which our support cannot be unconditional. The 'Arab Spring' seems rather to reinforce the importance for us of seeking better understanding of the domestic arrangements which govern the relationship between rulers and citizens. Our policy analysis needs to be able to recognise failings in the contract between leaders and led: how do they affect our relationship? Can we help? If so, how? These are not just questions for DfID.

26. One scheme that I have seen floated is for aid to be part of a contract, with each instalment given on conditions that, if met, will allow the next tranche to be given. The first instalment would be a loan, but need not be repaid so long as the recipient kept the bargain. As the good performance becomes an established continuing trend, success could be rewarded by more and larger grants promised over longer periods. Such ideas look useful for application, sector by sector.

27. In Kenya, I calculated that the cost of corruption to the economy in the first eighteen months of the first Kibaki government was not far short of the value of all aid to Kenya. It exceeded by far total remittances repatriated by overseas Kenyans. So cutting corruption will itself release more aid, and make it more effective. It will strengthen confidence, encouraging remittances and inward investment. Less aid could even have more positive impact.

28. With many Africans downplaying the value of our aid by comparison with what China can offer - without the inconvenience of governance strings attached - the scope for exercising leverage may seem limited. Yet, the citizens of many African countries, generally poorer than those feeling the wind of the 'Arab Spring', look to donors to show more solidarity with them in the face of bad governance, and to be less indulgent of those who govern them.

29. We also need to confront the flaws in our approach to aid. Policy-obsession with the Millennium Development Goals has shortened and narrowed our vision. One challenging paper* published last year argued:

"Taken as a whole, the institutions of the aid sector… resist changes in the analysis which might lead to their exclusion from opportunities…….. this includes the overseas development ministries, the vast UN system, the World Bank and other intergovernmental bureaucracies, some …….NGOs and the businesses that benefit from ODA funds. In developing countries, this includes politicians and bureaucrats and their clients, as well as NGOs and all others benefiting directly or indirectly from the current system. This web of vested interests creates a massive inertia, preventing those within it from seeing things clearly and devising more appropriate approaches."

30. We need to demonstrate that British government policy is alive to this; will rise to our responsibilities in a co-ordinated way; and will follow an international policy in which official aid, cultural, military, diplomatic and private commercial and charitable endeavours make a consistent and coherent impact in poor countries; those policies must be consistent with our means, and with the recipients' ability to work with us on their side of the bargain - to deliver on the things that are in their power to do. Above all, we need to engage with peoples, not only governments.

* *Working with the Grain to Change the Grain (International Alert, September 2010).*

6 June 2011

Sir Edward Clay, Sir Tim Lankester and Lord Jay of Ewelme—Oral evidence (QQ51-81)

Evidence Session No. 3 *Heard in Public* *Questions 51 - 81*

TUESDAY 5 JULY 2011

3.45 pm

Witnesses: Sir Tim Lankester, Lord Jay of Ewelme and Sir Edward Clay

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Hollick
Baroness Kingsmill
Lord Lawson of Blaby
Lord Lipsey
Lord Shipley
Lord Smith of Clifton

Examination of Witnesses

Witnesses: **Sir Tim Lankester**, former ODA (now DfID) Permanent Secretary and World Bank and Treasury official, **Lord Jay of Ewelme**, former ODA (now DfID) official and FCO Permanent Secretary, and **Sir Edward Clay**, former High Commissioner in Kenya and Uganda.

Q338 The Chairman: Good afternoon, gentlemen. This is the third public hearing of this Committee's inquiry into the economic impact and effectiveness of development aid, and we are delighted to have such distinguished witnesses before us today. Thank you very much indeed for coming, and special thanks to Sir Edward Clay for his paper to us, which I hope the other two of you have been able to glance at. I would be grateful if you would speak loud and clear in the usual way for the webcast and the shorthand writer, and since there are three of you, if you agree with the response of the first responder to any question asked, please do not feel that you have to supplement it. You do not always have to come in, but we can see how that goes. Would any of you like to make an opening statement, or can we go straight to questions?

Sir Tim Lankester: Straight to questions.

The Chairman: Thank you very much. We have a lot to cover and I know that one of you needs to go by 5 pm. Can I begin with a fairly fundamental question? On what core principles should UK aid be anchored? Can I also ask, to get us off the ground, about the 0.7% target? I know that Sir Edward Clay has expressed views about the target in his paper to us. For example, he has said the commitment is now inappropriate and out of date and that it is not at all clear why 0.7% should have its special status now. So, it is a sort of general question and specific on the target.

Lord Jay of Ewelme: Shall I have a go first, Chairman?

The Chairman: Please.

Lord Jay of Ewelme: I should declare an interest first because I chair the medical aid charity Merlin, which receives funds from DfID.

On the first question—to what core principles should UK aid be anchored—I would say: help for the poorest, help for growth, building up Governments' capacity to govern effectively, promoting human rights and countering corruption. In addition to that, aid has to be and be seen to be effective. I would state those as core principles. As for whether or not current aid reflects those now, I think that to a large extent it does. I am glad that there is a greater emphasis now on growth than has been the case in the past, because unless you have the economic growth, you are not going to get the help that the poorest need, so I am glad that aid is helping that more effectively than it has done in the past.

On the 0.7% target, I disagree with Edward Clay. I think it is important to have some disagreements here. I think that the 0.7% target is partly a real target and partly an aspirational target, and I think, provided there is an aspirational target there, there is a greater chance of countries, including ourselves, getting there and, therefore, a greater chance of getting aid through to the poorest people and to those who need it, so I would favour sticking to the 0.7% target. I am not in favour of it being a legislative obligation. I do not think you should have figures like that as legislative obligations. They are questions of policy, and sometimes policy can change and there are good reasons for that changing, but I would stick to the 0.7% target.

Sir Edward Clay: I would say that the purpose of aid can be put in two ways. One is to build resilient and responsive societies with institutions that give their peoples security and increasing welfare. To put it another way, from a purely British point of view, you could say that the purpose of our aid should be to build societies that people want to stay in. I think that is a factor that is implicit in what we try to do. It rarely is put as crudely as that. I think that an increase in welfare is right. I think we should be trying to increase the responsiveness and the responsibility of Governments towards their citizens and the robustness of their institutions. We should be reducing inequality and unfairness. I do not think that is what our current aid policy does. It does bits of it incidentally.

The 0.7% has had its day. The aid scene is transformed since that was set 41 years ago. It is an aspiration. There are far more donors now then there were then. There is far more development assistance going to the poorest countries, and why choose 0.7%? If I remember rightly, the Prime Minister slightly tweaked the epaulettes of the better off in Britain for not giving enough to charity and said that the aim should be for the well-off to give 3%, so why not 3% for rich societies? It seems to me that to deliver aid on the basis of numbers is to lose sight of what it is we should be trying to do and then finding the means to do that at whatever level it takes.

Sir Tim Lankester: I think the purpose of aid should be as it is set out in the 2002 Act, namely to reduce poverty. I think it is excellent that there is this single objective that is entrenched in law. That is not just increasing the income of the poor, it is improving other aspects of quality of life: life expectancy, reduced maternal and child mortality, better education and civil rights. I think it encompasses all those things, and I think it is very good that DfID now have this single objective. It does not mean to say that everything has to go into for example agriculture. It can go into improving governance and police reform in order to reduce poverty.

On the point about the 0.7%, I think it is worth having as an aspirational target and I am delighted that this Government has decided to stick with the previous Government's commitment in that regard. I think that money can be spent well. After all, there are nearly 1 billion very, very poor people still in the world and I think we have a Department for International Development that has the capability to spend the increased money well. I can explain now why I think that is so, but maybe you will want to come back to looking at the effectiveness of the Department in a moment.

Q339 The Chairman: I think we will. Lord Jay, you have outlined a number of admirable principles, but how do you make distinctions over the years as to what proportion goes in which, or what priorities change?

Lord Jay of Ewelme: Of the principles that I mentioned, I think I would put help for the poorest as the main priority. If our aid programme is not designed to help the poorest people on the globe then I do not think we should have it. In order to do that, it seems to me you also need to be focusing on increasing growth in poor countries, because that will help the main objective of helping the poorest people. I do not think you can do that either unless you have as an aim the things that reflect the values of our own society, which are opposition to corruption and the promotion of human rights. You can take any one of those out, but I think they do actually go together and they can together make a coherent programme, but I would put help for the poorest people at the top of that.

We have all been involved one way or another in aid. I started working in the Ministry for Overseas Development. My first job in the Ministry for Overseas Development was working out how we should respond to the Pearson target of 0.7%. Some things go round and round and round. Some things have changed a lot over the last 40 years or so, and we will come on to this, I am sure, but a lot of the work that Tim did in ensuring that aid was untied has, I think, made a huge difference to the quality of the aid we give and to the chance of reaching the objectives that we have now. So there are changes and evolutions and no doubt there will be more, but I would put help for the poorest people as being the main reason for having an aid programme.

Q340 Baroness Kingsmill: I just wondered how many strings you think should be attached to development aid. I do not mean necessarily that we should be seeking to pursue our own objectives when we are giving development aid in particular, but should we have a system of KPIs to indicate whether the aid has reached the right people and has achieved the objectives we have set out? Should there be more transparency, perhaps, about what we are seeking to achieve in the countries in which we give aid, and more transparency about whether or not we think we have actually achieved it?

Sir Tim Lankester: I entirely agree with you. We need to make sure that our aid is being well spent and we need to build up indicators—KPIs—and I think that is what DfID does. There is more evaluation going on in DfID than there is in any home Department in Government. I have worked in four Departments of Government and there is a lot more monitoring and evaluation of spend by DfID than there is in other Departments, but more can be done and the Coalition Government is putting a huge amount of emphasis on that.

DfID should not be providing aid unless it is reasonably confident that the aid is going to be spent and achieve the objective for which it is spent. However, having decided that 30% of the aid is to go in fragile states, inevitably it is going to be more difficult. Aid is best spent in countries where you have competent government. Fragile states on the whole do not have competent Governments, so there is a trade-off here. If we want to spend the money in very difficult places, there are going to be greater risks. The risks have to be monitored and managed, and there are definitely cases where DfID has to say, "No, we are not content with the governmental arrangements for spending the money, so we have to find other ways of doing it and go for another sector or use NGOs as a different channel".

Q341 The Chairman: On the point about current aid policy reflecting these principles, do you think that we should be doing more to distinguish between countries? For example, should we be giving aid to India?

Lord Jay of Ewelme: I think we should be distinguishing between countries. You are going to have to make judgments country by country, and within each country you are going to have to make judgments as to exactly which of your objectives are the key ones. I think India is now a marginal case because in many ways it is extremely wealthy. On the other hand, there are very large numbers of poor people there and I think there are ways in which we can help, but it seems to me it has a lower priority now than it did some 15 to 20 years ago and a lower priority than a number of other countries in the world, particularly in Africa.

Sir Tim Lankester: Chairman, I wonder if I could commend to the Committee, if you have not looked at it yet, the *Bilateral Aid Review*, which DfID produced earlier in the year. I think it is one of the best pieces of work that DfID have ever done. It is a superb analysis of need and ability on the part of the recipients to spend, and it does conclude that India deserves substantial amounts of aid. I agree with Michael that the Indian Government could be doing more for its own poor, but there are still 300 million to 400 million extremely poor people in India, and I think DfID have found ways of addressing their needs. It is only in relatively recent years that the Government of India has agreed that DfID should spend money directly in the states. There was a time when we had to go through the Government of India; now it spends money directly in Andhra Pradesh, in Orissa and in other poorer states and I think it is having a very good impact there.

Q342 Lord Lawson of Blaby: So many questions have already arisen that I do not know where to start, although one place I suppose we can start is by saying that this inquiry is not about the motivation or reason behind the aid programme. I think we can take it as read that the intentions are good, and they may well be as Lord Jay explained, but that is not what we are looking into. What we are looking into, if I may read the rubric, is the economic impact and effectiveness of development aid, and so the question then is, how effective is it?

In a sense, I think that economic growth must come probably at the top of the list. How effective is aid in promoting economic growth, not least because, as Lord Jay pointed out, having economic growth is the way in which you reduce poverty. The question is, as I say, how effective is it? Is it the case, incidentally, on the 0.7%, that the other two agree with Lord Jay that it is absurd that this should be not an aspiration but a legislative requirement?

Sir Tim Lankester: I do not think it is absurd, but I think it is arguable. If I was a Member of this House—which I shall never be, I am sure—I do not think I would support such a Bill, but no, I think it is good that the 0.7% is there. It would be absurd if DfID had to spend 0.7% willy-nilly, whether or not the money could be spent well, and if the legislation had that effect then it would be absurd.

Sir Edward Clay: If I may, I do not think it is absurd but I do think it is strange. It is a form of hypothecation, and that runs a number of risks. The first is that it makes aid primarily quantitative rather than a qualitative matter of policy—have you hit your targets for expenditure, never mind what is done? Secondly, I think that it will possibly be domestically controversial. These are not very small numbers or marginal numbers that we are talking about. They are very large numbers—I give some comparisons in my paper—and it would be very unfortunate the 0.7% target discouraged people or switch them off from their very generous support of NGOs both here and in recipient countries.

Q343 Lord Lawson of Blaby: Certainly, it would seem that focusing on quantity rather than quality is pretty rum, and it also pretty rum when it leads to a situation that we have now, in which, say, the Foreign Office budget is being cut back and DfID is roaring ahead—pretty much every budget has been cut back with the exception of DfID—and that this should be somehow in law rather than a policy decision that Government would take from time to time on the merits of the case.

Lord Jay of Ewelme: I would agree with that exactly as you put it, Lord Lawson. I do not want to give the impression that by saying that I would prefer it not to be in law, that I do not agree with the aspiration of the target. I think it is a good target to aim for, provided that it can be well spent—and I will come on to that—because I think that has an impact on our own Government, to have a target that is clearly stated as being an aspiration. I also do think it has an effect on other Governments as well. If we are clearly saying we are going to reach 0.7% by 2013 and doing our best to get there, that has an impact, because we make that point in the World Bank and we make that point in the DAC and elsewhere. It has an effect on others too. I do not think we should underestimate the impact that a British aid target and the quality of British aid can have on others.

Q344 Lord Lawson of Blaby: May I ask two final questions before moving on? First of all, do you think, in the sense that there are two arguments, you could say, "Where there is great poverty or a non-functioning Government, this is terrible for the people and therefore aid should be focused there", or could you say, "Aid should be concentrated where it is most effective. This may be tough, but it is the sensible and rational thing to do"? On that issue, where do you stand?

Sir Tim Lankester: It is a difficult balance. I think the moral case is to help those in most need. It is immoral, I think, to walk away from the very poor in countries where states are not functioning, so if necessary I would spend some money in helping the poorest in states where Governments are not doing performing effectively. The *Bilateral Aid Review*, which I referred to earlier, does try to take a view on this balance. It looks at capability to receive on the one hand and need on the other. I certainly do not accept the view that Government should walk away from countries where states are not functioning well. I think we have a duty to help and do what we can, even in places like Somalia.

Q345 Lord Lawson of Blaby: But on morality, might you not also say that it is immoral to be propping up corrupt Governments?

Sir Tim Lankester: I would not be propping up the Government of Somalia; I would be working through non-governmental channels.

Q346 Lord Lawson of Blaby: Finally then, one of the main reasons for separation of DfID and the Foreign Office, taking DfID out completely, was to make it clear that the objective of British overseas aid was entirely the sort of thing that Lord Jay and, I think, you too, Sir Tim, have been talking about and has nothing to do with other very worthy objectives of British foreign policy. Do you think that is a good idea and do you think it is in fact what is happening? When you look at how much aid has gone recently to Iraq, Afghanistan and Pakistan, it does look as if—and I am not saying this is a bad thing; it may be a very sensible thing—wider foreign policy considerations have played a part.

Lord Jay of Ewelme: I can have a go at that first of all. I think aid should complement our foreign policy. On the first part of your question, I think it is right that DfID should be separate from the Foreign Office. I am not in favour of merging the two. I worked in the Ministry for Overseas Development when it was separate, I worked when it was part of the FCO and I worked in the FCO as well, and I am clear that the right structure is to have a separate DfID from the Foreign Office, but working closely together. In the past sometimes they have not worked closely together enough. I have been to embassies where there is almost open war with the DfID people at the other end of town. That was some years ago; I do not think that would happen now. I think there is a much greater realisation that the two have to work closely together. I think the objectives of aid should be as I said at the beginning, but I think it is also sensible that aid complements our foreign policy. That means that it is sensible that there should be an aid programme in Afghanistan at the same time as we are fighting the Taliban. That seems to me a sensible approach.

Sir Edward Clay: If I may, I would like to take that question and Lord Lawson's last one. I think that there are dangers for us in saying we may have to accept a margin of waste, a margin of corruption and a margin of ill governance as the penalty for undertaking an aid programme. The question is: what margin? Baroness Amos used the same argument in talking about the UN's need to get assistance into the Horn of Africa. How much of a tithe needs to go to people who are in fact responsible in part for creating the circumstances in which poor people are dying, not just because of the climate but because proper assistance cannot be got to them and proper development cannot be carried out, over many years? I think we cannot shrug off that question.

It seems to me that the International Development Act 2002, which enshrined the objectives of our assistance programme as being the reduction of poverty, has been an excellent instrument for steering us away from, in particular, aid and trade mixtures and things like that, but it has left DfID with a slightly narrow outlook. If you look at the World Bank's *World Development Report* of last month, there is an argument there that constitutes an earthquake for the aid scene. It says that the main obstacle to development is conflict—

societies in conflict. We know that societies that are breaking down will not achieve the millennium development goals. Those MDGs are what have been dictating the thrust of our development policy and that of others for more than 10 years now. They will not be achieved. Gordon Brown said to the Royal African Society breakfast last week that in Africa they will not be achieved for 100 years, never mind by 2015, so we are actually pursuing a bus that is accelerating away from us. We need to really think about how we could better use this large amount of money that we want to devote to trying to make the world a better place.

Sir Tim Lankester: I think Edward is being too pessimistic. The developing countries are on quite a good track for meeting the majority of the millennium development goals. The progress that has been made over the last two decades on primary education, on immunisation and on some of the indicators of health have been tremendously good and the proportion of those in deep poverty has fallen by between 10% and 15% over the last 20 years. There are some countries in Africa particularly where there is not a lot of progress, but taken overall there has been a lot of progress.

I think poverty reduction can help to prevent conflict. It is not sufficient to prevent conflict, but it can certainly help to prevent conflict and, in that sense, if our aid is focused on poverty reduction, it can make a contribution to reducing the risk of conflict. I do not think that aid in itself can prevent conflict. DfID is not qualified to spend money to prevent conflict and I do not think any other Government department in this country is either. The idea that you can pour in money to prevent a conflict, whether it is in Rwanda or Bosnia Herzegovina, is not one that I would ascribe to. I think in the 1970s, 1980s and 1990s we got into a frightful muddle in DfID pursuing multiple objectives, most famously in the case of the Pergau Dam, but there were many other cases too. For example, we gave helicopters to India to bail out the Westland Helicopter Company and those helicopters were never used by the Indians—they were cannibalised eventually for the Indian military. I think having a single poverty reduction objective, albeit complementing our other foreign policy objectives, is the right way to go.

Q347 Lord Lawson of Blaby: On that, surely Sir Edward is right that the greatest source of poverty and suffering in these parts of the world is what Alexander Pope called "Man's inhumanity to man". If you are providing funds that enable that inhumanity to be better armed and do more damage, which in fact is what is happening, then it is difficult to see that you are helping the cause that you wish to help.

Sir Tim Lankester: I would not help those Governments. I would be helping in the refugee camps of Somalia and Kenya. I would be helping with maternal and child health centres through NGOs in those countries. I would be keeping well clear of those Governments but I would not be walking away from their peoples.

Lord Jay of Ewelme: Can I just add one point, Lord Chairman? Tim mentioned earlier the emphasis on fragile states in recent statements by this Government on aid. I think part of the reason for an emphasis on fragile states, which I support, is to reduce the chance of conflict, because if you are getting development going in places where otherwise it might not, you make conflict less likely. We are never going to be able to stop it happening, but we can make it less likely and we can also spend well-targeted aid after a conflict in order to make it less likely that there will be a resurgence of conflict, so I agree with what Edward said about conflict. I think it is possible to have a targeted aid programme that can reduce the risk of conflict both before it happens and after it happens.

Sir Edward Clay: If I may make a point on that and take up Lord Lawson's reminder that the economic impact is an important aspect for us, the country I know best in respect to difficulties of governance getting in the way of effective aid is Kenya. When I was there and became infamous for talking about corruption in 2004, I estimated its cost conservatively at $1 billion, more than Kenya was receiving in aid over the 18-month period in which these various scandals had been uncovered. Last November, the Permanent Secretary in the Kenyan Ministry of Finance said that he reckoned that the loss of revenue through misappropriation and so on was $2 billion conservatively. Most people think that is a gross underestimate.

These are figures of macroeconomic significance and I think they undermine the point that Michael Jay makes about our obligation to the poor. Most of our aid goes through Governments with more or less difficulty. Governments comprise more or less the richest people in society. If they were not before, they very quickly become so. It is quite difficult for us to avoid associating ourselves with Governments that turn bad, whatever they were at the start. I think that makes the moral impact of our aid, as seen by the people whom we really wish to help, extremely dubious. They are not naive. They see people like me shaking hands with Ministers and handing over cheques or taking part in the opening of some school and so on, and they say, "Why are the British getting on such hot terms with that person who we know to be corrupt?"—an ethnic hatred merchant or whatever. That is a really difficult problem for us, I think. We have to face it, and we have to accept that if so much money is being lost in Kenya, then, for instance, the figure of lost revenue dwarfs the value of remittances sent home by Kenyans in the diaspora. Those remittances are really important to their families in Kenya. They ought to be important to the Kenyan economy. But people out here are not stupid; they are not going to send money back for wider social purposes or for investment if they think that it is going to get into the hands of people who will waste it. They have had to work hard for it in Europe, North America or wherever. They do not want to see their money wasted. They do not wish to invest in the future of a society that looks decrepit, so it is extremely damaging economically if our aid risks shoring up what is a fairly rotten structure.

The Chairman: I think we may come back to this because it is a very important question, obviously, and sanctions and so on come in there. We will come back to it a little bit later. I just want to move on for the moment.

Q348 Lord Best: Some of the evidence we have had before, and indeed some of the things that you are suggesting today, rather contrary to the points that Sir Edward is making, imply that we are rather good at aid in the UK, compared with a lot of other countries. We do it rather well, and it is suggested, not least in a recent article in *Le Monde,* that we do this much better than the French, for example. Do you accept that there is an impact on our influence in the world because of the way we do aid? Is it a positive influence if people think that we do it rather well? Does that help us in terms of our wider foreign policy objectives? Let me pose that to you.

Lord Jay of Ewelme: I think we do have a good reputation for having—everything is relative in this world—relatively high-quality aid and having a high level of aid, and I think we have argued our case in international fora, for example, in a way that has redounded to our credit, so I think you can argue, and I would argue, that a good-quality aid programme is good in a wider sense for Britain and the reputation of Britain. I would not overplay the point, but I think it is worth making and I think the point in the *Le Monde* article is perfectly valid, although I am always rather suspicious of anything in the British or French press that tends to favour one or the other country. I think it has been a good story and has been recognised as such. If you look at some parts of the world—if you look at Sierra Leone, at Liberia or at Ghana—these are countries that are doing a lot better now than was the case, say, 15 to 20 years ago. That is in part, at least, a result of British policy and British aid policy and I think that is recognised. I think the answer to your question, Lord Best, is yes, but let us not overplay that.

Sir Tim Lankester: Can I make three points supporting the view that DfID does a good job in delivering aid? First of all, there are numerous evaluations—many hundreds—that have been done on DfID projects over the years. Evaluations are extremely complicated because you do not know what would have happened in the absence of the aid, and there are data problems, but a significant majority of these evaluations indicate that there are positive outcomes from DfID projects and programmes, notwithstanding the sorts of problems that Sir Edward has referred to in some countries.

Secondly, DfID is very well regarded internationally. I think it is regarded as the best of the bilateral aid donors. We used to think that the World Bank was the tops at aid. I do not think that is any longer necessarily the case. The World Bank regard DfID as very much on a par with itself and other donors do too. I was in Washington a couple of weeks ago, and both at the World Bank and USAID people spoke incredibly warmly about DfID and they did not need to do that to me, so I think it is very well regarded. The OECD reviews regard DfID very highly.

Thirdly, in 2007, DfID was subject to one of the Government's Cabinet Office capability reviews, and of the 10 that were conducted that year, DfID came out top when judged against leadership, strategy and delivery, so it is a strong Department. It is a skilled Department. It is very committed. No doubt it can do even better, but it is working in very challenging situations. I would like to come on to the question of staffing later. Perhaps that will come up or should we deal with that now?

The Chairman: I think we will come on to that later.

Q349 Lord Lipsey: One of the great developments in Britain's aid policy over recent years has been the move from tied aid to untied aid. I do not think it is controversial among serious people that untying aid is good for the recipient countries, but is there a case to be made that it is also good for the donor country and its own self-interest to avoid having tied aid?

Sir Tim Lankester: From the point of view of aid effectiveness, if we want to get the most bang for our buck in terms of poverty reduction, there is no doubt that untying is a good thing. There was an OECD study in the 1990s that suggested that aid tying added something like 20% to the cost of our aid. From the point of view of the British economy, you could argue that the tying of aid is effectively a subsidy, and if subsidies are a bad idea then aid tying must be a bad idea from the point of view of supporting sensible growth in our economy. But I agree with you that it is a good thing that it went. It has made our aid more effective.

Lord Jay of Ewelme: The only point I would add to that is that, as has been the case in the past, sometimes you have had companies that have depended on tied aid or have come to depend on tied aid, and that reduces the incentive for them to become globally competitive, which I think, in an economic sense, is the right answer for our industry, so I would argue that it is the right answer for industry as well as the right answer for development.

Sir Edward Clay: I agree with both Sir Tim and Michael that untying has been a good thing from the point of view of our aid programme. I also agree with the high reputation that DfID has and the good example we set to many other aid agencies.

On the impact of our aid programme, I have to say I do not think that many poor people know that our aid is untied or would believe it if they were told, so I do not think its impact locally is all that great. It is certainly something I strongly support. I thought it was an immense strength in our aid programmes in the countries where I have been accredited.

Sir Tim Lankester: That could be because our technical assistance continues to be tied. I think it is the case that we are untied in respect to the goods but not in respect of technical assistance. These are the people who the poor in Kenya would be seeing—Brits.

Q350 Lord Hollick: Has the untying of our aid been appreciated by the countries who are recipients of our aid, and how has that appreciation been shown, or do they see us as a bit of a soft touch?

Sir Tim Lankester: I think they greatly appreciate it, but maybe Sir Edward can answer that since he has been on the ground in a recipient country.

Sir Edward Clay: I think the aid wonks in Government do appreciate it, but they are a tiny number. I think most of the people, including in Government and beyond in recipient countries that I know, would wonder why the British do not actually stick labels "Made in Britain" on our aid, as they see other countries doing, but I think the policy wonks understand and approve.

Q351 The Chairman: Does the emergence of all the new non-DAC donors, such as China, India, Brazil and so on, who I understand substantially give tied aid, make any difference to the appreciation of untied aid?

Lord Jay of Ewelme: I do not know the answer to that. I remember a conversation in Algeria when the Algerians were rather worried about the Chinese influence and were saying, "Look, you do need to worry. You need to watch out about the way in which the Chinese are suborning countries by giving them aid really without terms". But of course that aid is very often on quite hard loan terms, and in a few years time I think that attitude will change because the burden of that aid, of those tied loans, will become apparent, so I would argue that over a period of time the arguments are very much in favour of untied aid because, as I said, I think that is right for our industry and I think it is right for development.

The Chairman: Next subject.

Q352 Lord Hollick: You all made reference to the importance of economic growth in terms of creating an economy that can alleviate poverty and is sustainable. In that context, do you think that there is greater scope for co-operation between DfID and the private sector? What I have in mind here is the large number of companies that are investing in projects in Africa and, indeed, the number of investment funds that are now being set up. Clearly, they have skin in the game. Would it not be sensible to work alongside some of these companies to help build economic growth? Possibly, to address one of the points that Sir Edward makes in his interesting note about the huge sums delegated to multinational agencies that are much less open to rigorous scrutiny, would the partnership with the private sector not help to shed more light on the effectiveness and impact of aid?

Sir Tim Lankester: I do not think you could have growth anywhere unless there is a thriving private sector, but how you use aid funds well to support the private sector is quite difficult. I think the key elements for the private sector are good macro-economic policies, good regulatory policies and rules that enable and enhance the ability of the private sector, good infrastructure, good skills and adequate savings to support the investment. Quite how aid can help in all that is difficult. I think aid can help with skills, and this is an area where I think DfID does not do enough. DfID's emphasis on education is largely at the primary level, although some of it is secondary.

I believe that high-level skills are absolutely critical for a thriving private sector. One of the great successes of aid in India from the 1950s and 1960s was the aid for the institutes of technology from which many of the budding entrepreneurs in India have come. We, the British, supported those institutes of technology. In Africa, aid donors generally have done far too little in supporting skill development, both at a technical level and with people who are going to go out and run businesses.

I think there is scope for aid to leverage investment but I do not think aid should be subsidising investment. This is the problem. There may be some guarantees, but the idea that aid should come in as a subsidy I do not think is quite right. I think the model of using aid as if it is a private investor is a good one. Aid is channelled through CDC, for example, to Actis, which is a private equity firm, and is then used on the private equity model to provide jobs and value added, but I think this is an area that needs to be further explored, and I think it will be very interesting to see how DfID come out on this, because I do not think they have yet made up their minds how they can best address the issue.

Lord Jay of Ewelme: I think the only point I would add—and I agree with that—is that I think aid can help through technical assistance and advice to bring about the conditions in developing countries that ensure that there is a thriving private sector and a fair private sector. It can help in ensuring that there are procurement policies that are open and fair and that in turn will lead to better private sector companies getting the contracts, so I think there is a way there in which aid can help the development of the private sector.

Sir Edward Clay: I agree with Sir Tim, that in the area of skills there is room for some symbiosis. But on the whole I think that good successful private sector activity depends on, if possible, aid helping to create the level playing field and the institutions that support that. All of the notable and revolutionary changes in Africa that have come from the private sector have come without need of any kind of midwifery from aid or Government or anything else—the mobile phone, ICT and so on. Those are the things that have transformed life beyond all recognition.

Q353 Lord Shipley: Can I go further into the issue of evaluation of aid, our programmes and the lessons we have learnt from that, but in very specific terms address a question to Sir Edward Clay? You blew the lid in Kenya on the issue of corruption. I am not clear whether you did that because evaluation had demonstrated that there was such a very significant financial leakage loss or whether that was already known but had not been publicised. What is it that we should be using evaluation for, and should we be in a position where such an explosive thing needs to be said because the extent to which there has been loss of money in a particular country is not publicly understood?

Sir Edward Clay: I think the answer to your question is that there were 18 infamous scams that caught my attention in 2004. They were not all new and they did not involve the skimming off of large chunks of British money. Even if they had, I do not think that DfID's evaluations would have told me about it. The evidence of such scams existing or continuing to exist from one Government to another was, to some extent, available. People had not pulled it together. One of the wonderful things that has happened in Kenya since then is that people have started perusing the annexes to the budgets—those obscure and boring bits, the back pages—which is where I found quite a lot of the stuff lying around waiting to be picked up. Everybody knew there was a lot of corruption. Lots of names of companies and projects were being mentioned but the jig-saw had not been put together. That is where we came in and drew attention to their combined size and the fact that corruption continued from one Government to another. The corrupters went on for ever. We used to say about Britain that "whoever was in Government, The Whigs were in power". In Kenya, the corrupters were in power and what they did was attach their teats to a new set of Ministers as Governments changed, and in that way they suborned the Government of Kenya for year after dreary year. The most notorious projects were in the security sector where, because of supposed sensitivities about national security, scrutiny was imperfect and people thought that they would never be discovered. They became very careless.

The other point is that these were robberies at the expense mostly of the Kenyan taxpayer. It was not a question of DfID's money being taken or this or that donor money. What we were doing was giving the Government an alibi. We provided development funds that enabled the Government to continue to have a development budget. This was literally how my DfID colleague described the way the Government of Kenya worked. In the meantime the Government dipped its hand into the till of its own running costs and helped itself, and that was a surprising and shocking confirmation of what many Kenyans believed but had not had authoritative confirmation until that point.

Q354 Lord Shipley: Can I pursue that? It was not clear from what you said whether some of this was suspected as happening in the UK but simply had not been collated because people had not looked at the back pages of the budgets, or was it something that, despite going on for a number of years, you yourself brought together, so that this might be going on elsewhere where evaluation has failed and that, were you to be somewhere other than Nairobi, you might have looked at the back pages of other budgets. In other words, is this, from your perspective, a particularly Kenyan matter or is it a failure of UK evaluation more generally?

Sir Edward Clay: You said in the UK. Did you mean the UK or in Kenya?

Lord Shipley: I meant UK officials who supposedly are evaluating what is happening in a country such as Kenya.

Sir Edward Clay: Corruption—to use one word that is an alternative to governance—has been an obsession of aid and foreign policy in a country such as Kenya for decades. The reason I took it up in 2004 was because it seemed that we had talked enough about it. There was no question but that we were against it, and if the evidence was found, we ought to expose it if we were serious about doing something to stop it. In London the issue had much, much less prominence. It always featured in Ministers' briefs. We always intoned the same mantra – how deplorable corruption is – and hoped that it would never be found on our watch and come and bite us in the way it has, and Kenyan Governments wish that in spades. It was not a subject that was being actively monitored and studied in London; it was being studied by us in Nairobi and we thought it our job to do so.

Q355 The Chairman: Have things changed since that time? Could we have a similar situation going on still, and does evaluation focus on that?

Sir Tim Lankester: Can I come in on this, Chairman? I think I would like to distinguish between the corrupt use of aid funds and corruption more generally. DfID should ensure—I believe to a large extent does ensure—that its own funds are not used corruptly, and it has tightened up in recent years. Before making a grant to the Government, for example, for education or health, it conducts a fiduciary risk review. It puts in place auditing arrangements to track the spend.

A couple of years ago, it discovered that there was corruption in the use of its funds for an education sector project, and the grant was suspended, and I think this is subject to a NAO report at the moment. In the use of our own aid funds, the situation is not quite as bad as Sir Edward says, in general. Maybe there were more cases in Kenya, but DfID is very focused on this issue.

There is also the more general question about corruption generally. If a country is so corrupt that all we are doing is allowing education to carry on simply by the use of the money we put in, we should not be doing it, and an assessment has to be made. None of the recipients is ever going to be completely clean. It is a matter of degree. Maybe during Sir Edward's time in Kenya there was too much corruption in general to justify the sort of programme we had, but remember that corruption is to some extent a function of poverty. Poor countries, as we know from our own experience in the eighteenth century, tend to be corrupt. As they come out of poverty they become less corrupt. There is never going to be a country that we deal with in Africa or Asia that is entirely clean. It is a matter of the degree to which we are prepared to put up with it.

Lord Lawson of Blaby: Chairman, it might be useful if we had—not from our witnesses today, but from somewhere—a factual account of how many programmes have been cut off because of corruption.

Sir Edward Clay: May I just add a gloss to what Sir Tim has said? The discovery that DfID's £1 million had disappeared without proper explanation in 2009 led to its diverting funding from Government and into NGOs. That of course makes it much less efficient. However, there has just been another audit carried out by the Ministry of Finance in Kenya, which discovers that the loss is not £1 million, but - to a collection of donors, including DfID, who put money into a pot for primary education - the loss is around £47 million. So, it is unfortunately the case that the more you dig, the more you find. The question is, do we have the motivation to dig?

Q356 Lord Hollick: How does DfID go about checking the efficacy and efficiency of the substantial amount of spend that goes through NGOs?

Sir Tim Lankester: It conducts evaluations in the same way as it conducts evaluations at any other—

Q357 Lord Hollick: It has the same degree of access and oversight, so there is no difference there?

Sir Tim Lankester: No, there should not be. No.

Q358 Baroness Kingsmill: Is corruption the biggest risk to DfID's reputation?

Sir Tim Lankester: I would think that in Africa, yes.

Lord Jay of Ewelme: It is important to stress, as Tim did earlier on, that there is a degree of corruption in any developing country. That does not mean that all money you give to that country is going to be misused. There are ways in which you can evaluate, in which you can work with parts of a Government that are less corrupt than others. If there is corruption in the capital then, as an aid agency, you can work at local level through people who are less corrupt, so there is no absolute here. There are some countries that are more corrupt than others. Ultimately, if you get to a stage where you simply cannot operate as an aid agency, it seems to me that you just decide, "Well, we withdraw from this country", but that is a very serious step to take because that means you are not then able to help the people who really need help. There is a balance here all the time and there are ways of working with parts of Governments in places where the corruption is less, and of giving aid in such a way that corruption is less likely to happen. To think that corruption will not happen is unrealistic.

Q359 Baroness Kingsmill: Is the best way to deliver development aid to do it government to government, when corruption is such a big issue—

Lord Jay of Ewelme: No, it depends on the country. There are some countries in which you can be reasonably sure that the corruption is at a level that it will not impinge on the effective use of that aid. There are other countries where you can be pretty sure that it will impinge on the effective use of that aid. In those cases you need to find some way of using the aid in which you are going to avoid the risk of corruption. That may, as I say, mean working with a health ministry, if that is relatively clean, or of working in some part of the country where there is an administration that is less corrupt, and that is something that DfID is well aware of, as I understand it, and it will look country by country at how it can be sure that the aid it gives is best used. Then of course there will be evaluation of each project or each programme and, as I understand it, a more and more intense and complex evaluation than was the case some years ago.

Some things are fairly readily able to be evaluated but some things in which aid is given are not, and that is quite a tricky issue.

Sir Tim Lankester: One should not assume that NGOs are necessarily clean either. You need to do a fiduciary risk analysis of the NGO.

Q360 The Chairman: If the leakage, if I can put it that way, is sufficiently substantial, what sanctions are there in some of these countries to really make clear that the aid cannot continue at this level if corruption is so great?

Sir Tim Lankester: Well, you stop the aid or you reduce the aid. In Kenya there was a time when we reduced the aid because of this. I think it is difficult in countries where there are other interests besides poverty reduction. If you are trying to build a strong relationship in other aspects of foreign policy then there may be pressures not to take this sort of action.

Lord Jay of Ewelme: There may be, but you should never publicly accept that corruption is there and you are going to accept it. You do not; you fight against it and you try to ensure that you have the sort of programmes that prevent it happening and you make the sort of speeches that Edward made in Nairobi, which do have a real impact. That should be a constant theme of any aid policy and foreign policy to make certain that we are not supporters of it and we are opposing corruption where we find it.

Q361 Lord Lipsey: May I ask, Sir Edward, if you could give a potted history of the remarks you made in 1994? How were they cleared with Government and were there arguments within Government as to whether this was appropriate for somebody in your position to do? It very much reflects on whether the theory that we are not doing it for foreign policy reasons is in fact accurate.

Sir Edward Clay: It was 2004. In 1994 I was—

Lord Lipsey: Working up to it.

Sir Edward Clay: I was in Uganda, but that is a different story. I think that in 2004 Michael Jay was my PUSS. He will tell you that London had my remarks in advance. What I said was in accordance with Government policy, and the then-Government and its Minister kindly backed me up, which is not to say that it did not cause a ruckus. Three Ministers were removed in fairly short order and two are now out of politics in Kenya.

On Lord Hollick's last question, DfID can monitor NGOs quite effectively. Any of us who have been involved in one of our NGOs' applications to DfID for a grant knows that the process of getting a grant is enough to drive strong men to drink. It is very, very exigent, and quite rightly so.

On corruption, I think one has to read the signs. They are not secrets. They are not things that are not known. Reputations are not unknown. Throughout the period from 2005 to 2009 in which this now £47 million loss of donor funds has been discovered, DfID responded to questions; "Are you happy with your funding of the education budget?" "Yes, yes, we have every confidence." In the first two years of it I asked: "Are you happy to administer this through an Education Minister who is the central character in Kenya's most infamous scam to date?" which was the Goldenberg scandal. "We would rather get the children into school then worry about that." If you will forgive me, the first time I ever went abroad was to go to the Great Lakes in Africa, to Burundi, as a volunteer in refugee camps. The refugees there were the victims of the first pogroms carried out by the then Rwanda Government. This was the 1960s. In 1994, I found myself in Kampala accredited to the then now unlamented Government of Rwanda during the period of the genocide. The people who came back into Rwanda then were the people I knew - some of them actually met - back in 1964.

You have to take a long view, but in the 1960s a lot of people excused the Government of Rwanda for its pressure on its minority by saying, "This is a social revolution working its way through", and we indulged them. The Chinese indulged them. The Belgians indulged them. The French supported them, and the French were indeed their main support, up until the point at which the roof fell in: the genocide was perpetrated by the Rwandan Government which people with lots of experience in the region had been supporting with aid, military advice, technical assistance, and so on. In a period of 35 years, we really should have learned to read the signs and to act on them, and I think we have a very, very short term view, unfortunately, in our foreign policy and our aid policy. That is partly because we want to achieve quick results on the one hand and partly because our foreign ministry has seen its personnel and its expertise reduced over the years.

The Chairman: That perhaps takes us on.. We would love to follow this further—it is really very interesting—but in the interests of time we will have to move on to the next subject.

Q362 Lord Smith of Clifton: If the administration and staff costs resources of DfID are being diminished and reduced while its aid programme is being expanded, what is the capacity of DfID to monitor these grants and aid programmes? It would seem to me, looking from the outside, that we are going to have worse monitoring because there will not be the resources back in headquarters to take this view and to develop a more historical perspective that we can learn from.

Sir Tim Lankester: I entirely agree with you on that, Lord Smith. It is unrealistic for the administrative costs to be reduced at a time when they are increasing their budget. It is not just evaluation. Aid is a very complex business. It requires enormous skill and attention in designing projects and programmes, and it is quite wrong that the Government is reducing its staffing of this. It is dogmatic. Just because other Departments are reducing their staff does not mean that DfID should. If you are going to have an increasing programme, you need to retain the staff. It is possible that they can shift some of their staff costs on to so-called programme costs, which I expect they will be doing in a roundabout way to get around the Treasury. I would hope this Committee might give a signal to Government that they should not be applying the same sort of staff reductions as they are to other departments. If the Government wants a strong programme and an increasing programme, they cannot afford to reduce the staff at this time.

Lord Smith of Clifton: I guarantee you will have a minority report if my colleagues do not agree.

The Chairman: I am sure other departments would say something along the same lines.

Sir Edward Clay: If I may just add, there is a complement to that in receiving countries where administrations are relatively weak and relatively understaffed in proportion to the resources they have to disperse. The Kenyan National Taxpayers' Alliance—I will give you a copy of this if you wish, Chairman, for those who are taking the record—have just summarised the sums left in Ministries' budgets last year that could not be spent. They are very, very large sums indeed, very significant sums that could have built 50,000 km of roads, supplied every school with at least two classrooms and so on. The question of absorptive capacity at the receiving end is a very important aspect and it means that funds do not get spent.

Q363 The Chairman: Is that because of the lack of skilled staff there to handle the projects and so on?

Sir Edward Clay: It is the lack of systems to disburse this money effectively and successfully, and perhaps the lack of skilled staff to oversee the achievement of programmes that have been designed at headquarters.

Sir Tim Lankester: If I might add, it is also a function of the complexity of the aid system, and one of the advances of recent years is the attempt by donors to harmonise and get together. I believe that Tanzania a couple of years ago had to receive over 1,000 missions from aid donors. For a creaking Government that is quite an absurd number of missions to deal with. I think the Paris Declaration of 2005 is leading to greater co-operation among donors, so they pool funds, they pool monitoring and they pool evaluation; that is very important.

Lord Jay of Ewelme: If I could just add, in a sense it is the same thing as you have both said. If you have a policy that is to increase aid quite substantially and you have a very clear requirement to show that that aid is being used effectively, that means you have to have a more staff-intensive programme for evaluating it, and if at the same time you are cutting your staff, you are facing yourself with a real and, it seems to me, almost insoluble problem, so I think this issue of cutting the staff at the same time as you are increasing the budget and increasing the staff intensity of administering that budget is quite difficult to reconcile.

Q364 Lord Best: Can I ask about the consequences of cutting the aid budget? We are always talking about growth, heading for 0.7% and so on, but apart from the immorality of doing so—let's set that to one side—what would be the consequences if we cut our cloth somewhere near the level that the administration could cope with? What would be the effects on UK plc of there being a smaller aid budget?

Sir Tim Lankester: We would not be helping so many countries; we would not be taking as many people out of poverty. Those are the consequences. It might affect our soft power in the world if it was known that we were pulling back while a number of other countries are expanding their budgets.

Lord Jay of Ewelme: That last point is quite important. We would lose not just a moral advantage but the ability to pull other countries up by our own example. If you look back on that afterwards, it could look serious.

Q365 The Chairman: Can I just be clear on the administrative question that we have just been discussing? Is this because of a diktat that has gone to all Government Departments about reductions in administrative spending, which therefore applies in DfID and that you cannot argue that some of the staff are actually intrinsic to the particular aid programmes and therefore should not be cut?

Sir Tim Lankester: I think that is the reason, isn't it?

Lord Jay of Ewelme: You would need to ask DfID, Chairman.

The Chairman: Well, we will.

Sir Tim Lankester: But there are ways in which you can switch staff costs onto programme costs.

The Chairman: That is what I was getting at.

Lord Jay of Ewelme: Yes, and that is the question that you need to ask DfID: is it now possible, and have the Treasury agreed, that you can in fact have people who have hitherto been on the administration budget from now on on a programme budget, and therefore you can keep the levels up? I do not know what the answer to that is or what the scale is, but on the face of it there is a potential problem in increasing the aid programme and increasing the need for evaluation and decreasing the number of people you have to do all of that, if that is the position they are in.

Sir Edward Clay: I think, if I may, I remember that DfID could in fact treat staff—they could meld running costs and programme costs, and then the Treasury jumped on them. I remember the Chief Economist at DfID, on being asked four years ago whether the ceiling on manpower, which was the main instrument for controlling Whitehall numbers, applied to DfID, replied: "Yes, it does, and will continue to apply even as the budget rises".

The Chairman: It is certainly a question we will ask too. We are coming to the last questions, to fit in with the timetable.

Q366 Baroness Kingsmill: I feel slightly embarrassed asking this question after the discussion that we have just had, but do you think there is such a thing as too much aid? Do you think we could create a culture of dependency in some of these countries? Do you think that possibly it makes it more difficult for the recipient governments to establish themselves effectively in the eyes of their own people? Is there a sort of imperial overtone? I say that slightly provocatively, but I think you know what I am getting at.

Sir Edward Clay: I think there is a lot in that, and public perceptions in Kenya are not as positive about our aid programme as you might expect because of the confusion that we create in the public mind. The old and rather sour apophthegm was that aid comes from the pockets of poor people in rich countries and goes into the pockets of rich people in poor countries. If we really believe that we are helping to abolish poverty in poor countries, we are going about it in a rather self-defeating way, but is there not a better way?

How does one get in touch better with the public? There are ways of doing this, including using social networks, blogging and so on. You could have heads of DfID and ambassadors talking to the public direct. There would be enormous resonance. In 2004 and 2005, I really tried to say, "This explosion on my part is not a donor wagging his finger at Kenya. This is a donor saying, 'Actually, we are on the side of the Kenyan taxpayer and the non-taxpayer who are all being abused by the misappropriation and misuse of funds to which we jointly contribute: us through aid and them, more importantly, through taxation'. This is an issue that affects all of us. It is not our shoes as donors that the Government vomits on; it is on the shoes of everybody, including the feet of those who do not have shoes", and that is why I had some impact locally.

Q367 The Chairman: Does that criticism that you just made about what happened during that period—I mean the reaction from the local population—apply to multilateral aid in the same way?

Sir Edward Clay: I do not think either donor publics or recipient publics really understand what multilateral aid is all about. They may see the results, but how it connects them to people who contribute the taxes from which come our subventions to the World Bank or the IMF or the European Commission or the UN family is not really well understood. They see the result and they are glad of that.

Sir Tim Lankester: The poor of Kenya are pleased when they have a clinic that is open. They do not particularly mind who pays for it. I do not think they feel dependent on aid, and they are just very happy that there is a clinic where they can take their children for immunisation.

We have spent a lot of time talking about Africa. In India, where we are spending £300 million to £400 million a year, aid represents less than 1% of that country's GNP for total aid: I refer to the World Bank and everybody. It is minimal in terms of total Government spend, so the idea of aid dependency in India just is not there at all. I think there is a danger in some African countries.

Lord Jay of Ewelme: Going back to Baroness Kingsmill's specific question, I think there are circumstances in which a country would find it difficult to absorb aid, and if the answer to that is for us, say, to try to channel money through multilateral donors, and you have too many multilateral donors and you have too many bilateral donors and each of them has their own ways of doing things, that can be quite a burden on the country. An important question is: what is the right level of aid that a country can sensibly absorb? And if you do give too much, that can have disadvantages.

Q368 Lord Lawson of Blaby: May I briefly raise one other problem that many people are concerned about? I refer to the system of aid that has not yet been aired in the very interesting evidence we have had from all three of you this afternoon. We have talked about the problem of corruption, and aid, despite good intentions, in fact is enabling the corrupt to be corrupt on an even greater scale. We have also spoken about how aid can allow those who have a desire to oppress their peoples or a minority of their peoples to be able to do that on a greater scale. But even if there is a government that is not unduly corrupt, which does not particularly wish to oppress its people or a minority within its people by military means, there is something odd, if you are trying to promote economic development, about giving it through governments, which means the relationship between the Government and the private sector will be tilted in favour of the Government, yet we know, from experience, that a healthy private sector is the best way of getting successful economic development. In other words, you are promoting an economic model that is the exact reverse of what is likely to deliver the objectives that you all agree you should seek. I know it is difficult to ask how you depart from it, but this seems to me and to many people who are very knowledgeable in this area to be a major problem.

Sir Tim Lankester: I totally agree that the private sector is the key to development but, Lord Lawson, governments have a relatively small part to play in these countries compared with ours. Typically, Government spend in Africa will be 15% to 20% of GDP whereas ours is 45%, so the public sector—

Lord Lawson of Blaby: If I may say so, I think you need to distinguish with regard to what Government spends for social purposes. I am talking about the economy, the economic dimension.

Sir Tim Lankester: I was going to say that the best aid at present can probably be spent on the social sectors. That is where there is greater success and probably where there is greatest need in health and education. Taking the private sector, aid donors have come back to the idea that infrastructure needs supporting. There was a time in the 1980s and 1990s when aid donors moved away from infrastructure, but countries need ports, roads and airports.

As I said earlier to Lord Hollick, I think it is very difficult for aid donors to subsidise the private sector generally. They can support good economic policy, infrastructure and skills, and that does require going through governments, normally. You can have a PFI for a road but, on the whole, it does mean working through governments.

Sir Edward Clay: In addition, there is the leverage we have through our general position in an aid-receiving country. On account of our development assistance programme, our political relationship and so on, we ought to be able to help the private sector in some important respects to get off its knees in such countries. For example, one of the touchiest issues in any African country is land. It is touchy domestically, it is touchy in a foreign policy sense, and it has given particular point at the moment because of the interest from other countries—from the Middle East and the Far East—in buying up agricultural land and growing themselves food and so on. But unless African states get land ownership and a proper system of controlling transfers in place and honoured, they will not get anywhere. We know of cases where foreign investors, including those from Britain, get done down. There is a case in Tanzania at the moment that is notorious. We should be more ready to say to the Tanzanian Government, "Look, these people happen to be British, but if they happened to be Congolese, the way you are behaving **-** harassing them, denying the validity of a perfectly legal land leasehold and the right to make a good thing of it for the benefit of your country **-** is not only monstrous but terribly damaging. You will never get foreign direct investment. You will never get Tanzanians in the Diaspora wanting to invest money at home if it is such a chancy business.", That is something we can usefully do.

Lord Jay of Ewelme: I do not think it is quite as black and white as Lord Lawson was saying. There are ways in which aid can help the development of the private sector, the conditions in which the private sector can thrive and the conditions in which you will get effective private investment; at the same time, aid is necessary to try to help the poorest people directly. The extent to which you can do that will vary from country to country, but you can do both.

The Chairman: Gentleman, we have run out of time, I am afraid. We could have gone on for very much longer, and that is a tribute to the experience and expertise from all of you, from which we have benefited this afternoon. Thank you very much.

Sir Edward Clay—Supplementary written evidence

House of Lords' Economic Affairs Committee hearing on 5 June.

1. Towards the end of the Committee's evidence session on 5 July, Lord Lawson asked about the private sector's role in development of the economy in aid-receiving countries. I referred in my reply (at about 17.04.45 of the video recording) to a case in Tanzania of foreign private investors who deserved support against official and non-official ill-treatment calculated to deter private investment generally.

2. This case – Silverdale Farm - is known to civil servants. FCO officials have taken the matter up with the government of Tanzania, without success. It has been brought to the attention here of some parliamentarians and ministers in the AAPPG, International Development Committee, FCO and DfID. It has apparently not evoked any response, save from Roger Gale MP. The essential elements are –

a. allegations of fraud,
b. breaches of the rule of law including intolerable harassment,
c. unlawful physical and other threats against an expatriate couple who had in good faith and following the proper procedures invested in land in Tanzania for agricultural development;
d. and abuse of power or refusal to exert their proper authority by Tanzanian officials and ministers under pressure from well-placed Tanzanian businesspeople.

3. The couple concerned – Stewart Middleton and Sarah Hermitage - are relatively small scale private investors. It has been an article of faith with DfID for years – as Sir Tim Lankester's reply to Lord Lawson confirmed - that development will chiefly come from private enterprise. That requires developing countries to create the conditions to encourage foreign and domestic investment. Silverdale Farm is a glaring example of how not to do it. And in the process a British couple has been damaged financially, physically and morally. Their treatment has been outrageous.

4. I assume this government means what DfID have for long said about development coming from the private sector and that, given the emphasis placed on trade promotion, they wish British investors, large or small to prosper in the process. How are they to be protected against the kind of expropriation and unlawful pressures we used to see in Africa in the 1960s and see in southern Africa now?

5. The indifference of MPs and ministers in a position to understand the Silverdale Farm case contrasts to their sensitivity in responding to the needs of Britons in another kind of danger, during the evacuation from Libya.

6. Is this couple's plight not also worthy of ministers' interest? Might they not make an effort to use the leverage we ought to have by dint of our position in Tanzania – including a very large aid programme with a large element of direct budgetary support – to press for proper redress?

11 July 2011

Sir Edward Clay—Further Supplementary written evidence

Bill Sinton Esq
Clerk to the Economic Affairs Committee
House of Lords

Dear Bill,

I am grateful for the Committee's interest in knowing my reaction to the International Development Secretary's letter to Lord MacGregor of 3 August. Andrew Mitchell sent me a copy of that letter at the time, having earlier told me privately that he was "dismayed and disappointed" by my testimony at the Committee's session on 5 July.

Andrew Mitchell tries to undermine my testimony on grounds that I am out of touch. Would he also discount views more to his liking from other witnesses on the grounds of their age, or is the gibe reserved for his critics? I responded to the Committee's invitation to make a submission and give oral testimony on the explicit basis of my experience, stated at the top of my paper.

Looking at the substance of Andrew Mitchell's letter, I am struck by the degree to which he evidently feels some of the matters I raised are still important current preoccupations. His long letter says forcefully they are being addressed.

Proclaiming policy, however emphatically, is not the point. The Committee's interest is in the impact and economic effectiveness of development aid. If Andrew Mitchell turns out in one year to have discovered the aid version of the philosopher's stone, I shall applaud. Meantime, I am glad he acknowledges the force of my concerns, and shares them.

Andrew Mitchell misleads in his comment on my supplementary submission, about Silverdale Farm. He claims that Coalition Ministers – "fearless ……..about governance" - have made and will make representations on this case. If they have, present ministers have not told the couple involved in the Silverdale Farm case. Indeed, they have not responded at all to Mr and Mrs Middleton's submissions. Perhaps the Development Secretary might now consider doing so himself. The Middletons are surely entitled to know the result of his colleagues' representations to senior Tanzanians with the power to right the grievous wrongs done to two bona fide investors in their country's agriculture.

Yours sincerely,

(Edward Clay)

Friday, 9 September 2011

Sir Edward Clay – Further supplementary written evidence

Dear Secretary of State,

Your letter to the Chairman of the Economic Affairs Committee of 3 August clearly seemed to you to offer a complete riposte to my criticism of your Department's lack of resolve to tackle corruption. You anticipated the return of the one million pounds lost by DfID in the latest scandal in the Kenyan Ministry if Education. It now seems that you will get your money back (apparently, the World Bank will, too, though I am not sure about other donors).

You miss the point, if I may say so, in anticipating with such satisfaction this refund of your stolen funds. The point was eloquently made – not, alas, for the first time – in an editorial in The Nation of 9 November. It was entitled *"Why is it that nobody is ever guilty of theft?"*

The editorial recalls that, after months of investigations and the repayment of nearly £5 million to the World Bank and DFID, the five officers mandated to investigate what the Editor regards as one of the major scandals in recent years, arrived at a verdict of no guilt, meaning "that earlier reports about lost cash were made by delirious fellows seeking to besmirch the good names of top government officials".

As the editor asks: if that is so, why return the money?

His despairing question recalls the ludicrous defence over six years ago of a Kenyan minister who hoped to bury one of the most egregious dodgy contracts in the family of scams known as Anglo-Leasing. He claimed that the money had been returned on that contract. Though he would not say by whom, he said that didn't matter and everyone should take comfort from the refund.

The British Government has got its money back in this current case. DfID has lived down to Napoleon's characterisation of us as a nation of shopkeepers. Now we can get back to business as normal. (And the World Bank, too, of course. They were among those also warned, who also shot the messengers).

But what have your policies done to address the systemic problem of corruption, and its attendant, a culture of impunity in Kenya?

The point you have missed, in the way your predecessors missed the warnings about the folly of 'investing' in a government whose most distinctive characteristic was its endemic corruption, is that corruption is not a victimless crime in Kenya. Our aid helps provide an alibi for bad governance. In doing so, we disappoint those in Kenya who struggle against the venality of their rulers. We discourage those who look for resolution, not pay-offs.

We fail to help create an environment in which our aid – and private investment, and remittances from overseas Kenyans - can safely and usefully be deployed. DfID have been warned of Risk in this context for seven years at least. The Public Accounts Committee recently criticised your Department's inability to assess and respond to Risk; your policies, in Kenya at least, will sustain, perpetuate and aggravate fiduciary risk.

DfID gets its money back. A much larger price, paid by Kenyans themselves in terms of their domestic revenues stolen and services denied, will continue to be misappropriated.

How does that march with your assurance to the Economic Affairs Committee, in the penultimate para of your letter to Lord MacGregor, that you regard it as a purpose of UK aid to "deliver a fundamental change that empowers people" and "strengthen the ability of citizens to hold decision-makers – including governments and service providers – to account"?

There is much to celebrate in Britain's achievements through its development programmes. I am ashamed and disappointed that we continue to be so incoherent and self-deluding in the face of poor governance. Fiduciary risk is a manageable hazard for UK taxpayers, but it is an insult and a grievous denial of reasonable expectations of services to the citizens of poor countries we claim we want to help. Europe's own current plight should remind us of what damage corruption can do, and the folly of thinking it will cure itself and isn't our affair.

Yours sincerely,

Edward Clay

(Edward Clay)

Monday, 14 November 2011

Professor Paul Collier—Oral evidence (QQ 317-337)

Transcript to be found under Ev. 9 (Professor Philip Booth and Richard Manning)

Professor Paul Collier—Supplementary written evidence

In response to Q321 of the evidence given by Professor Paul Collier on 1 November 2011, the follow-up information below has been provided by Ruurd Brouwer.

‘example of a successful use of public money to encourage private investment’

A nice example is of course FMO[109] itself. During 25-30 years the Dutch state injected Equity up to an amount of EUR 660 mln (called, “development Fund”, but part of our tier I capital). This, and a state guarantee on our capital market funding, allows FMO to invest the private funding we attract on the international capital markets in developing countries. Today, after adding the retained profits & reserves our equity is at EUR 1,3 bln (so no money was ‘lost’) and FMO invested EUR 0,9 – 1,4 bln per annum over the last 5 years in the private sector of developing countries every year again, have a substantial development impact and make a sustainable return as well.

The weak spot lies in the fact that the private money falls under the state guarantee and therefore does not take direct developing country risk.

There are also examples of smaller initiatives. Mostly they take the form of the state taking the first loss risk in a debt fund to take the first hit as a result from credit risk and/or forex losses. This allows DFI’s to invest in the lower risk tranche and commercial players in the lowest risk tranche. It must be said though that under current market circumstances it is more difficult than ever to find private investors for developing countries,

Ruurd Brouwer /Director/ Financial Institutions

3 November 2011

[109] FMO is a Dutch development bank. We invest in companies, projects and financial institutions in developing countries.

Department for International Development—Written evidence

Please find enclosed the Government written evidence in respect of the House of Lords Economic Affairs Committee's Inquiry into the Economic Impact and Effectiveness of Development Aid.

I welcome this very timely inquiry into the impact of development assistance. It poses many of the same questions the Government asked itself on coming into power. The Government gives high priority to identifying the results of aid and to its evaluation. That is why I established the Independent Commission for Aid Impact (ICAI), to undertake evaluations of UK aid and report directly to the International Development Committee of the House of Commons. This independent scrutiny and our own focus on results and evaluation will help us to increase even further the impact and the value for money of our aid programmes.

This Government has also put a new and far greater emphasis on the roles of the private sector, of international trade and of investment in generating the economic growth that is helping developing countries to grow out of poverty. As they become wealthier, developing countries become more attractive trading partners for the UK, better able to deal with natural disasters and climate change and less dependent on aid. Ultimately the purpose of our aid is to make itself redundant.

I look forward to the opportunity to discuss these points and others areas of our aid programme with the Committee in person.

The Rt Hon Andrew Mitchell, MP, Secretary of State

THE ECONOMIC IMPACT AND EFFECTIVENESS OF DEVELOPMENT AID

Introduction

1. This submission uses the evidence available to answer the twelve questions posed by the Committee in their call for written evidence. For coherence, the questions are grouped into five themes:

- Theme 1. The Relationship between Aid and Economic Growth
- Theme 2. Aid Effectiveness
- Theme 3. Aid Allocation
- Theme 4. Private Sector and Aid Interactions
- Theme 5. Fragile States and Security

2. The inquiry is very timely as it asks many of the same questions as the Coalition Government asked itself on coming into power and which guides its policies on overseas aid. The Secretary of State for International Development has made clear that using evidence to maximise the effectiveness and value for money of British aid is a top priority for the Government and this is now deeply embedded in the objectives and processes of DFID. And where evidence does not exist DFID is committed to developing it through research, evaluation and conscious learning from experience. DFID's new priorities on engagement

with evidence allows it to guide expenditure and policy efficiently and place the British Government in the position where it is widely regarded by aid agencies and development specialists as at the cutting edge of international development, of which Britain can be justly proud.

3. UK aid is about generating opportunity and prosperity for poor people in developing countries. It is the private sector that delivers the economic growth needed to achieve this and the Government has developed a new approach to working with it, doing more with and for private enterprise, extending the private sectors' reach to new development areas, and engaging with it more productively. Government policy also emphasises the role of international trade and investment in helping developing countries to grow out of poverty. As they become wealthier, developing countries become more attractive trading partners for the UK, better able to deal with natural disasters and climate change and less dependent on aid. Ultimately the purpose of aid is to make itself redundant.

4. The Government maintains a clear focus on results and the independent evaluation focused on assessing the impact of Official Development Assistance (ODA)[110] on growth and development. The responses to the questions posed by the Committee draw on the best economic analysis and the latest evidence available. However, development involves complex chains of causation. So the attribution of any particular result to a given aid (or any other) intervention is not always straightforward. A residual level of uncertainty and imprecision will sometimes remain.[111] (see Annex 1 for greater elaboration).

THEME 1: THE ODA-GROWTH RELATIONSHIP [Q1, Q2, Q3]

[Question 1] How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, what has been the impact of British ODA? How robust are results from studies in this area?

5. *Summary:* There is considerable micro and macro-economic evidence that ODA is of benefit to recipient countries.[112] There is also evidence that the effectiveness of ODA has increased over time and that it can help recipient countries attract private investment.[113] Research shows that timely and appropriate ODA can significantly increase the chances of a sustained turnaround, even in the most complex of development circumstances. [114,115] The

110 The OECD glossary of Statistical Terms defines ODA as - Flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent (using a fixed 10 percent rate of discount).

111 Francois Bourguignon, when Chief Economist and Senior Vice-President of the World Bank made similar arguments in F Bourguignon and M Sundberg 'Aid effectiveness – Opening the black-box', American Economic Review, vol 97(2), May 2007, pp. 316-321

112 E.g. Goldin, Rogers, and Stern. (2002). The Role and Effectiveness of Development Assistance: Lessons from World Bank Experience. A Research Paper from the Development Economics Vice-Presidency of the World Bank; Tseday Jemaneh Mekasha and Finn Tarp 'Aid and Growth. What the meta-analysis reveals' UNU Wider Working Paper No 2011/22;,UNU WIDER: Helsinki

113 For example, the average return on World Bank projects was 16% in the 1980s, increasing to 23% by the late 1990s (Goldin Rogers and Stern (2002)). Each dollar invested by the World Bank brings in nearly two dollars of private sector investment.

114 E.g. Chauvet and Collier (2006) A helping hand? Aid to Failing States. Working Papers DT/2006/14, DIAL

115 Paul Collier and Jan Dehn (2001) Aid, Shocks, and Growth, World Bank Policy Research Working Paper No 2688

most recent and reliable finding is that a continuing aid inflow of around ten per cent of GDP spurs per capita growth rates by one to two percentage points per annum in the long-run.[116]

6. *Background:* There is a wide body of literature which attempts to unravel the complex interrelationships between ODA, productive investment, growth and poverty reduction.[117] Although some recent studies have challenged the impact of aid on growth[118] the vast majority of the research shows that aid has a positive impact on growth. Evidence of impact of properly executed and well designed aid programmes at the micro-level is strong, widespread and established in the economics literature. Evaluations of projects continue to indicate positive rates of return [119] while a number of formal impact evaluations show that well designed projects generate positive returns and increase the incomes and welfare of the poor.

7. Recent authoritative research[120] into the aid-growth relationship, using the most up-to-date available data and best methodology, concluded that "aid has a positive and statistically significant causal effect on growth over the long run". It finds that an aid inflow of around ten per cent of GDP spurs per capita growth rates by one to two percentage points per annum in the long-run. [121]

8. Much aid is spent on providing immediate benefits rather than directly on economic growth – e.g. health, education and other poverty reduction and social welfare investments. If these expenditures are well-directed they will eventually increase economy-wide productivity and hence the growth of incomes as, for example, workers become healthier and better educated. It may take many years for these gains to materialise, however, and their impact might be masked by other exogenous factors – such as conflict, natural disasters or global recession – so actual growth rates show no increase relative to previous trends.

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116 Based on analysis of data for 1960-2000. Arndt, Channing; Jones, Sam; and Tarp, Finn (2010) "Aid, Growth, and Development: Have We Come Full Circle?," Journal of Globalization and Development: V1: Iss. 2, Article 5. http://www.bepress.com/jgd/vol1/iss2/art5/

117 See the summary literature review in Channing Arndt, Sam Jones and Finn Tarp (2010) Aid, Growth, and Development: Have We Come Full Circle?

118 For example, Raghuram Rajan and Subramanian (2008) "Aid and Growth: What does the cross- country evidence really show?" Review of Economics and Statistics, November 2008, 90(4): 643-665. William Easterly "Can Foreign Aid buy Growth". The Journal of Economic Perspectives, Volume 17, Number 3, 1 August 2003 , pp. 23-48(26) Arndt, Jones and Tarp argue that the failure to identify effects reflect methodological weaknesses.

119 World Bank (2008). Annual Review of Development Effectiveness 2008: Shared Global Challenges, Independent Evaluation

120 Arndt, Jones and Tarp (op. cit) and Tseday Jemaneh Mekasha and Finn Tarp (2011) Aid and Growth: What the Meta Analysis reveals" UNU-WIDER Working Paper No. 2011/22; Helsinki.

121 Mkesha and Tarp (2011) find the coefficient of aid on growth is between 0.14 and 0.17 depending on the method of estimation. This implies that a 1% increase in aid is associated with an increase in GDP growth of between 0.14 and 0.17%. Tarp (2011) concludes that the results of WIDERs 2010 /11 research programme is that over the long run aid an aid inflow in the order of ten per cent of GDP spurs per capita growth rates by one to two percentage points. For example, recent work by Hanushek and Wossmann has shown that while it is difficult to prove a relationship between educational enrolments and growth, cognitive skills that would be acquired through education do have a positive impact on ,growth. Hanushek E.A. and Wossman, L. "Education and Economic Growth", p. 245-252 International Encyclopedia of Education, 3rd

121 Mishra, P. and D. Newhouse (2007), Health Aid and Infant Mortality, IMF Working Papers, 07/100, International Monetary Fund. Cited in Tarp, F. (2010) see footnote 1.

121 Arndt, C, Jones, S. and Tarp, F., (2007), "Aid and Development: the Mozambican Case", in Lahiri (ed.), Theory and Practice of Foreign Aid, Frontiers of Economics and Globalisation, Vol.1, Amsterdam: Elsevier. Colleir, P., (2007) The Bottom Billion, Oxford: Oxford University press. Both cited in Tarp (2010) foot note 1.

121 Hudson, J. and P. Mosley (2008). Aid Volatility, Policy and Development. World Development

Hence while we may be unsure about how much and when such aid has contributed to growth, it is highly unlikely that it has had no effect.[122]

9. So, at country level, aid can contribute both to poverty reduction and to many of growth's pre-requisites. It can help to build infrastructure, expand social services with positive effects on non-growth outcomes such as infant mortality[123], health and education, and attract private sector investment (see below).[124]

10. Overall, once the macro evidence is combined with the micro evidence a consistent case for aid effectiveness emerges. In other words aid remains an important tool for enhancing the development prospects of poor nations.

[Question 2] How does economic growth in countries which experience large surges in ODA compare to similar countries which do not?

11. *Summary:* Increases in aid increase the resources available to a poor country to spend or invest and will tend to make it better off. The impact on growth of large surges in ODA which, for example, increases foreign aid inflows by several percentage points of Gross Domestic Product depends on how recipient countries use the aid flows and the strength of their monetary and fiscal policies. It is important to distinguish between the effects of large sustained and predictable aid inflows and unpredictable and volatile aid surges, which can be more difficult for a low-income country to manage.

12. Over the long run, as long as aid is used to increase economy-wide productivity, it will increase growth.[125,126] In the short run, however, the economy has to adjust to increased availability of foreign exchange; this can appreciate the real exchange rate due to increased demand for non-tradable goods and services and the resulting shortages of skilled labour, which can dampen growth effects.[127]

13. Experience shows, however, that such adjustment costs are not inevitable.[128, 129] A recent study [130] which looked at the impact of ODA surges in five countries, Ethiopia, Ghana, Mozambique, Tanzania and Uganda, found strong export performance and no evidence of real exchange rate appreciation. In fact, these five countries are among the 17 emerging

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122 For example, work by Hanushek and Wossmann has shown that while it is difficult to prove a relationship between educational enrolments and growth, cognitive skills that would be acquired through education do have a positive impact on ‚growth. Hanushek E.A. and Wossman, L. "Education and Economic Growth", p. 245-252 International Encyclopedia of Education, 3rd Edition,

123 Mishra, P. and D. Newhouse (2007), Health Aid and Infant Mortality, *IMF Working Papers*,07/100, International Monetary Fund. Cited in Tarp, F. (2010) see footnote 1.

124 Arndt, C, Jones, S. and Tarp, F., (2007), "Aid and Development: the Mozambican Case", in Lahiri (ed.), Theory and Practice of Foreign Aid, Frontiers of Economics and Globalisation, Vol.1, Amsterdam: Elsevier. Colleir, P., (2007) *The Bottom Billion*, Oxford: Oxford University press. Both cited in Tarp (2010) footnote 1.

125 Hudson, J. and P. Mosley (2008). Aid Volatility, Policy and Development. *World Development* 36(10), pp.2082-2102.

126 Adam, C. S.and D. L. Bevan (2006). Aid and the Supply-Side: Public Investment, Export Performance and the Dutch Disease in Low-income Countries. *World Bank Economic Review*. 20(2), pp.261-290.

127 Rajan, G. R., and A. Subramanium (2005) What Undermines Aid's Impact on Growth? IMF Working Paper WP/05/126. June 2005.

128 Berg, A., Aiyar, S., Hussain, M., Roache, S., Mirzoev, T., and A. Mohane (2007) 'The Macroeconomics of Scaling Up Aid: Lessons from Recent Experience", Occasional Paper, International Monetary Fund.

129 ODA Briefing Paper (2006). 'What would a doubling of aid do for the macroeconomic management in Africa?'. Overseas Development Institute, April 2006.

130 Aiyer, S.,A. Berg and M. Hussain (2008). The Macroeconomic Management of Increased Aid: Policy Lessons from Recent Experience, WIDER Research Paper No. 2008/79, September 2008.

African economies identified in a recent paper by the Centre for Global Development that have experienced GDP growth rates over five per cent a year between 1996 and 2008.[131]

14. The evidence shows that the main factor explaining the differences in the impacts of large increases in ODA on growth between countries is the policy choices that they made in response to the increases in ODA flows.

15. *Background:* Aid increases demand for all goods and services. While the aid inflows can finance an increase in the supply of imports, the supply of non-tradable goods does not increase over the short term so their price increases relative to that of tradable goods. This drags productive resources like labour out of firms producing tradables and so the export sector, a potent driver for growth, declines. [132]

16. There are, however, several ways in which such adverse impacts can be avoided.[133,134] First, if the economy is not running at full capacity, there will be spare resources available that the non-tradable sector can make use of. Second, if surges in ODA are used entirely to fund imports, the prices of goods and services produced for domestic consumption will not rise relative to that of tradable alternatives. Third, the ODA may be allocated in ways that quickly enhances productivity (e.g. through upgrading of infrastructure) both in the non-tradable and the tradable sectors. This allows the supply of non-tradables in the recipient economy to increase to meet additional demand generated by increases in ODA and also improves the international competitiveness of firms producing for the export market.[135] [136] Fourth, the increase in foreign exchange resulting from a surge in ODA can be accumulated as reserves and released only gradually to fund imports providing a useful 'cushion' against large ODA fluctuations.[137]

17. Thus the negative impact on growth that has sometimes been associated with large increases in aid actually reflects poor policy choices, not a law of nature.

[Question 3] What lessons if any can be learnt from the experience of former aid-receiving countries that have graduated from reliance on ODA?

18. *Summary:* There are a number of examples of successful graduation from ODA. The Commission on Growth and Development[138] identified thirteen countries which experienced high and sustained growth since the Second World War (see Table 1 below). Five of these countries have reached high-income status. They are all significantly less dependent on ODA than before.

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131 Radelet, S. "Emerging Africa: How 17 Countries are Leading the Way", Centre for Global Development publication, September 2010 http://www.cgdev.org/content/publications/detail/1424378/

132 This is known in economics as the 'Dutch Disease'.

133 Linsink, R. & O. Morrissey (2000). Aid instability as a measure of uncertainty and the positive impact of aid on growth. *Journal of Development Studies*.

134 Chervin, M. & S. van Wijnbergen (2009) Economic Growth and the Volatility of Foreign Aid, Tinbergen Institute Discussion Paper, TI 2010-002/2.

135 Collier, P. (2006). Is Aid Oil? An Analysis of Whether Africa Can Absorb More Aid. *World Development* 34(9), pp.1482-1497.

136 Killick, T. and M. Foster (2011) The Macroeconomics of Doubling Aid to Africa and the Centrality of the Supply Side. *Development Policy Review*. 29(s7), s83-s108.

137 Ibid

138 http://www.growthcommission.org/index.php?Itemid=169&id=96&option=com_content&task=view

19. Policies that have helped countries achieve high and sustained growth include high levels of investment in infrastructure, health and education and financial sector development. The experiences of countries such as Republic of Korea and Botswana highlight the role of investment in human capital and infrastructure, effective institutions and government policies that promote exports and encourage the private sector. They show that partnerships with the private sector play an important role in boosting economic growth.

20. *Background:* There are a number of ways in which graduation can be defined:

- The OECD Development Assistance Committee (DAC) defines all low and middle income countries[139] as eligible for receiving ODA other than those that are either EU or G8 members[140]. The bar for graduating from ODA is attaining a level of GNI per capita equivalent to the World Bank defined threshold for high income countries.[141] The DAC considers a country no longer to be eligible for ODA if it remains above the high income country threshold for three consecutive years.
- A lower threshold for graduation would be the one used by the World Bank's International Development Association (IDA). IDA is the part of the World Bank that helps the world's poorest countries by lending money on highly concessional terms. Graduation from IDA takes place when a country's GNI per capita stays above the specified IDA eligibility threshold ($1165 for financial year 2011) for three consecutive years. Countries crossing the threshold can still borrow from the World Bank but on terms that are less concessional. The most recent World Bank data shows that between fiscal year 1961 and fiscal year 2010, 35 countries graduated from IDA and eight countries reversed from graduation, bringing the net number of IDA graduates in this time period to 27 countries.[142]

21. A good example of a UK ODA recipient country that has graduated from the most concessional type of aid, including grant aid, is Vietnam. In 1990, Vietnam was among the poorest countries in the world, with GNI per capita below that of Nigeria and Sudan.[143] Between 1990 and 2008, it has achieved an average annual growth rate of over 7 percent a year and made great progress in achieving the MDGs.[144] For example, the under-five mortality rate has declined from 56 to 14 deaths per 1,000 live births, and the proportion of people living on less than $1 per day fell from 63 percent in 1993 to 15 percent in 2008.[145] ODA to Vietnam increased from under 3% of GNI in 1990 to a peak of 5.5% in 2000.[146] DFID support has averaged £54m per annum between 2005/06 and 2009/10.[147] Vietnam's economic success will allow it to graduate from UK development assistance in 2016.[148]

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139 Low and Middle Income as defined by the World Bank Analytical Classifications. Country lists available at World Development Indicators Online http://data.worldbank.org/data-catalog/world-development-indicators

140 www.oecd.org/dac/stats/daclist

141 set for financial year 2011 at GNI per capita greater than $12,195 in 2009 US$. Income classification thresholds and lists of countries in each category available at World Development Indicators Online http://data.worldbank.org/data-catalog/world-development-indicators

142 World Bank data, available at http://go.worldbank.org/PSTVR12110

143 World Bank World Development Indicators, Indicator Code NY.GNP.PCAP.PP.CD – GNI per capita (PPP, current international $s). GNI per capita in 1990 was $610 in Vietnam, $650 in Sudan and $920 in Nigeria. http://api.worldbank.org/datafiles/NY.GNP.PCAP.PP.CD_Indicator_MetaData_en_EXCEL.xls

144 ODI Development Progress, "Mapping Progress: Evidence for a New Development Outlook", ODI 2011 http://www.developmentprogress.org/global-report

145 ODI Development Progress, http://www.developmentprogress.org/progress-stories/viet-nams-progress-economic-growth-and-poverty-reduction-impressive-improvements.

146 World Bank World Development Indicators Online, Net ODA received (% of GNI).

147 Table 14.3, Statistics for International Development 2010, http://www.dfid.gov.uk/About-DFID/Finance-and-performance/Aid-Statistics/Statistic-on-International-Development-2010/

148 BAR Technical Report, p. 6

22. The graduation thresholds outlined above determine eligibility for different forms of development assistance. Eligibility does not necessarily imply reliance, but income levels are clearly an important predictor of whether a country needs ODA. Countries that experience rapid growth in income levels can offer valuable lessons on how to decrease reliance on ODA.

Table 1. The Thirteen Success Stories

	Period of High Growth**	Per capita income*** in Year 1 of high growth period	Per capita income*** in 2005
Japan*	1950-1983	2,500	39,600
Hong Kong, China*	1960-1997	3,100	29,900
Singapore*	1967-2002	2,200	25,400
Taiwan, China*	1965-2002	1,500	16,400
Korea, Rep. of*	1960-2001	1,100	13,200
Malta*	1963-1994	1,100	9,600
Oman	1960-1999	950	9,000
Malaysia	1967-1997	790	4,400
Brazil	1950-1980	960	4,000
Botswana	1960-2005	210	3,800
Thailand	1960-1997	330	2,400
China	1961-2005	105	1,400
Indonesia	1966-1997	200	900

*economies that have reached high income country per capita income level **period in which GDP growth was seven percent per year or more *** in constant 2000 US$. *Source: The Growth Report: Strategies for Sustained Growth and Inclusive Development*

23. The table above shows the per capita income levels for the 13 countries identified by the Commission on Growth and Development as success stories before and after their growth spurts.[149] All of these countries now have at least middle income country levels of income and the first six have high income country status. The high income countries are no longer eligible for ODA and those that have middle income status have graduated from the most concessional types of ODA such as IDA credits.[150]

24. Table 1 shows a group of very diverse economies that have grown successfully, but the Growth Commission identifies some factors that these countries have in common[151] and also discusses the "policy ingredients" that are necessary for long-term sustained growth.[152]

[149] p. 19, "The Growth Report: Strategies for Sustained Growth and Inclusive Development", Commission on Growth and Development, 2008. High Growth is defined as 7 per cent or more. Full report available for download at http://www.growthcommission.org/index.php?Itemid=169&id=96&option=com_content&task=view

[150] IDA is the part of the World Bank that helps the world's poorest countries by lending money (known as credits) on concessional terms. This means that IDA credits have no interest charge and repayments are stretched over 35 to 40 years, including a 10-year grace period. IDA also provides grants to countries at risk of debt distress. Graduation from IDA takes place when a country's GNI per capita stays above the specified IDA eligibility threshold ($1165 for financial year 2011) for three consecutive years. The country then receives lending on less concessional terms than those given to IDA eligible countries. IDA credits have no interest charge and repayments are stretched over 35 to 40 years, including a 10-year grace period. IDA also provides grants to countries at risk of debt distress.

[151] p.21, "The Growth Report: Strategies for Sustained Growth and Inclusive Development". The five factors these countries had in common are openness to the world economy, sustained macroeconomic stability, high rates of savings and investment, market allocation of resources and committed, capable governments.

25. These ingredients include high levels of investment in infrastructure, health and education and financial sector development. The DFID country and regional action plans[153] detail the results in these areas that British ODA is aiming to achieve by 2015 - for example, investment in upgrading 1,300 km of roads across Africa, sending over four million children to school in Pakistan, increasing the number of people with access to formal financial services by 10 million in Nigeria and making basic healthcare services available for 7.5 million people in Ethiopia.

26. These success stories share a further characteristic: a capable, credible, and committed government. There is extensive literature on the importance of institutions for economic growth.[154] The case studies of the Republic of Korea and Botswana illustrate the importance of good governance. Governance and security is one of the five essential pillars on which DFID's bilateral programmes are based.[155]

27. The experiences of Botswana and the Republic of Korea also show partnerships with the private sector play an important role in boosting economic growth. DFID's new approach to private sector led development seeks to harness the expertise and resources of private enterprise to increase investment and provide better public services in the poorest countries, creating jobs and opportunities for millions of people.[156] Further details of Republic of Korea and Botswana's success and the role played by ODA are given in Annex 2.

28. The ODA spent by DFID is targeting many of these key ingredients for economic growth so the insights from success stories are being used to improve the effectiveness of aid provision to countries that have not yet graduated.

THEME 2. AID EFFECTIVENESS [Q4, Q5, Q12]

[Question 4] What factors determine the effectiveness of ODA in recipient countries? Are they dependent on the scale and form of aid flows? How is aid effectiveness monitored?

29. *Summary*: A widely held view is that the quality of the recipient country's institutions have a significant impact on the effectiveness of ODA.[157] Hence, several of the multilateral financial organisations have developed indicators to assess institutional strength to use in aid allocation decisions. The World Bank's Country Policy and Institutional Assessment (CPIA)[158] is one example of these indicators. Institutional strength is however difficult to

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152 p.33 , ibid

153 DFID operational plans published 31st May 2011, available for download at http://www.dfid.gov.uk/Media-Room/News-Stories/2011/Action-plans-set-out-future-of-UK-aid/

154 Rodrik, Dani, Arvind Subramanian and Francesco Trebbi. "Institutions Rule: The Primacy Of Institutions Over Geography And Integration In Economic Development," Journal of Economic Growth, 2004, v9(2,Jun), 131-165.; Acemoglu, D., Johnson, S. and Robinson, J.A. "Institutions as a Fundamental Cause of Long-Run Growth", Chapter 6 in Handbook of Economic Growth, Volume 1, Part 1, 2005, Pages 385-472

155 para 25, p. 8, Bilateral Aid Review: Technical Report. Available for download at http://www.dfid.gov.uk/aidreviews

156 "The Engine of Development: The Private Sector and Prosperity for Poor People", DFID Publication, May 2011. Available at http://www.dfid.gov.uk/Documents/publications1/Private-sector-approach-paper-May2011.pdf

157 Burnside and Dolllar (2000) concluded on the basis of an econometric analysis of panel data that aid has a positive impact on growth in countries with good fiscal monetary and trade policies' but subsequent research has found that this result id fragile (see Arndt et al, 2010 "Aid Growth and Development: Have We Come Full Circle?").

158 The CPIA index consists of scores on 16 criteria grouped in four equally weighted clusters: Economic Management, Structural Policies, Policies for Social Inclusion and Equity, and Public Sector Management and Institutions.

measure and different types and combinations of institutions can encourage economic growth in different countries.[159]

30. Reflecting the importance of the strength of a recipient country's institutions, the Paris Declaration (PD) identifies country ownership as one of the central factors that contribute to aid effectiveness.[160] Ownership needs to extend beyond government ownership and be defined as a democratic process which involves parliament, civil societies and citizens more broadly.

31. There is no evidence that high levels of aid are ineffective.[161] The UK's experience is that scaling up our aid flows can help deliver significant improvements for poor people. The following two examples illustrate this:

- Bangladesh - the Overseas Development Institute's recent report on Mapping Progress identifies Bangladesh as a "star" performer country. It has made great progress in public health - life expectancy at birth has increased dramatically: a baby born in 1970 could expect to live only until the age of 44, whereas a newborn in 2008 can expect to live 66 years. Under-five mortality has fallen from 248 deaths per 1000 live births in 1960, to 54 deaths in 2008. Immunisation coverage has increased from one per cent to 89%.[162] UK ODA to Bangladesh increased by 157% from 1990 to 2009.[163] DFID's bilateral programme budget for Bangladesh was £157m for 2010/11 and is projected to rise for the five years till 2014/15 and will help to sustain this progress.[164]

- Malawi averaged seven per cent annual GDP growth between 2004 and 2009, well above the sub-Saharan African average. This has been paralleled by significant poverty reduction and a notable drop in inequality. Progress on human development is also evident - the country ranks among the top 20 performers on several Millennium Development Goal (MDG) indicators in terms of both absolute and relative progress. The UN Secretary-General has lauded Malawi for its progress: 'In a few short years, Malawi has come from famine to feast; from food deficit to surplus; from food-importing country to food exporting country'.[165] DFID aid to Malawi increased from £66m to £77m between 2005 and 2008[166] and is projected to increase to £98m in 2014-15.[167]

32. Nor is there one single way of delivering aid that is most effective. The PD evaluation found that no single aid modality (budget support, programmes and projects) can automatically produce better results.[168] An appropriate mix of modalities continues to be the best way to deliver aid.

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159 Rodrik,D. "One Economics, Many Recipes: Globalization, Institutions and Economic Growth", Princeton University Press 2007
160 p. 2 Wood, B; Betts, J; Etta, F; Gayfer, J; Kabell, D; Ngwira, N; Sagasti, F; Samaranayake, M. "The Evaluation of the Paris Declaration: Phase 2", Final Report, Copenhagen, May 2011. www.oecd.org/dac/evaluationnetwork/pde
161 Hansen, H., and F. Tarp (2001), Aid and Growth Regressions, *Journal of Development Economics*, 64: 547–70
162 ODI Development Progress, "Mapping Progress: Evidence for a New Development Outlook", ODI 2011 http://www.developmentprogress.org/global-report
163 World Development Indicators Online, http://data.worldbank.org/data-catalog
164 See Annex F, Bilateral Aid Review: Technical Report, March 2011
165 ODI Development Progress, see http://www.developmentprogress.org/progress-stories/improved-economic-conditions-malawi-progress-low-base
166 Table 14.1, Statistics for International Development 2010, http://www.dfid.gov.uk/About-DFID/Finance-and-performance/Aid-Statistics/Statistic-on-International-Development-2010/
167 Annex F, Bilateral Aid Review Technical Report, March 2011
168 p.49 Wood, B et al. "The Evaluation of the Paris Declaration: Phase 2", May 2011

33. DFID carries out its own rigorous evaluations and evaluation is carried out by all the multilateral agencies which receive our aid. The World Bank has an Independent Evaluation Department which reports directly to the World Bank's President. There have been a series of actions taken by the Government to improve the monitoring and evaluation of UK ODA and to ensure that all aid is used effectively. These include setting up an Independent Commission on Aid Impact which reports directly to Parliament (see Question 12) and significantly strengthening evaluation within DFID.

34. *Background:* The PD proposes five principles that positively contribute to aid effectiveness: results, ownership, accountability, alignment, and harmonisation. It lays out a practical, action-oriented roadmap to improve the quality of aid and its impact on development. All major donors have agreed to provide aid according to PD principles since 2005 and they reinforced their commitments in Accra in 2008.[169]

35. The Evaluation of the Paris Declaration (2011) includes more than 50 studies in 22 partner countries and across 18 donor agencies. Some of the main findings include.[170]

- aid provided following the PD principles contributed to more focused, efficient and collaborative aid efforts.
- compared with the aid situation 20 to 25 years ago current practice presents a global picture of far greater transparency and far less donor-driven aid.
- a key achievement has been the strengthening of country ownership of aid, enabling developing countries to increase the impact of aid by integrating it into their own programmes.

Monitoring and Evaluation (M&E) to ensure effectiveness of British ODA

36. Underpinning the work of the new Independent Commission on Aid Impact, DFID is investing heavily in evaluation to make it central to how staff work at operational level. The key changes are:

- More and better evaluation within DFID's programmes, which was materially lacking in many programmes previously. Each operational team, as part of its operational plan, is required to set out how it tackles evaluation, set priorities and build skills on M&E.
- More rigorous evaluation methods, including a larger number of impact evaluations using internationally-recognised gold standard methodologies.
- By 2015 every priority programme will have evaluation embedded from the start. The new business case procedures encourage programme staff to build evaluation in at the design stage, including collecting baselines and data on impact.

37. To achieve this expansion in the level and quality of programme evaluation, we have created a new professional cadre of results and evaluation specialists working in country and operational teams.

[Question 5] Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA? What has been the British Government's experience?

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[169] See http://www.oecd.org/document/ for countries that signed the Paris Declaration.
[170] p.xii-xv, Wood, B et al. "The Evaluation of the Paris Declaration: Phase 2", May 2011.

38. *Summary:* There is a wealth of evidence that suggests that imposing policy change through aid conditionality does not work.[171] The implementation of reforms depends on domestic political economy forces (commitment and ownership of governments) and not on aid conditionality. Changes in policy as a result of aid conditionality are the exception, not the rule. But the UK Government seeks to establish clear partnership principles to promote this.

39. The UK's own experience on conditionality concurs with the finding that imposing conditionality does not work. The UK does not use conditions to lever policy changes that a developing country government is not committed to, instead we agree to support policy reforms and programmes as partners. If a partner government is not committed to the partnership commitments of poverty reduction, respecting human rights and other international obligations, promoting accountability to citizens and strengthening public financial management and accountability, we do not use conditions to try to impose these commitments. Instead, in order that the poor people of the country can still be assisted, we may choose to support poverty reduction by working with partners other than government.

40. *Background*: During the 1980s and 1990s policy conditionality was common in multilateral and bilateral aid programmes. It is particularly associated with the World Bank's structural adjustment programmes and the IMF programmes that usually accompanied them. As the 1990s proceeded and evidence accumulated a body of research grew up that cast doubts on the effectiveness of conditionality.[172] Tony Killick (2004) summarises the evidence thus: "Countries which had received large numbers of successive highly conditional credits were still rated by the Bretton Woods Institutions (BWIs) as having weak, sometimes deteriorating, policies, with little apparent association between programmes and policy trends."[173] One apparent reason for the failure of conditionality policies was that domestic political considerations outweighed the impact of international aid signals. In some cases, leaders secured additional political support on the home front by openly defying international pressures.

[Question 12] In what ways, if any, can the British Government improve the effectiveness of its development aid?

41. *Summary:* The British Government is recognised as one of the most effective providers of development aid. The UK has also been identified as "the best among the bilateral agencies" in a recent independent study on aid practices[174] and an OECD peer review of DFID states that "The UK is a recognised international leader in development."[175]

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[171] Svensson, J., (2003) "Why conditional aid does not work and what can be done about it?", Journal of Development Economics, 70, pp. 381-402. Collier, P. and Dollar, D., (2001) "Development Effectiveness: What have we learnt?", Development Research Group, World Bank, January, http://www.oecd.org/dataoecd/16/2/2664872.pdf. Alesina, A., Dollar, D., 2000. Who gives aid to whom and why? Journal of Economic Growth 5, 33–64.

[172] Killick, Tony (2004) Politics Evidence and the New Aid Agenda,*Development Policy Review*, 22 (1): 5-29. This conclusion draws heavily on Killicks' earlier work Killick, Tony (1998) *Aid and the Political Economy of Policy Change*. London: Routledge and Overseas Development Institute and see also Collier, P., Guillaumont, P., Guillaumont, S. and Gunning, J. W. (1997) 'Redesigning Conditionality', *World Development* 25 (9), September. Crawford, Gordon (1997) 'Foreign Aid and Political Conditionality: Issues of Effectiveness and Consistency', *Democratization* 4 (3). Crawford (1997), Dollar, David and Svensson, Jakob (2000), 'What Explains the Success or Failure of Structural Adjustment Programmes? Economic Journal 110, October. Svensson J. (2003) "Why conditional aid does not work and what can be done about it?" Journal of Development Economics, Vol. 70, Issue 2.

[173] Killick, Tony (2004) Politics Evidence and the New Aid p 13.

[174] Easterly, W., and Williamson, C.R. (2011), "Rhetoric versus Reality: The Best and Worst of Aid Agency Practices", http://dri.fas.nyu.edu/docs/IO/19960/Rhetoricvsreality.pdf

[175] OECD – Development Assistance Committee (2010). The United Kingdom Peer Review.

42. However, the Government is not content that enough has been done and is aware of the need to continually strive for improvements in the effectiveness of aid, in order to deliver better results both for poor people and for the UK taxpayer. The UK now wants to see a much stronger focus on results, value for money, transparency and accountability. This was set out clearly in DFID's recently published Business Plan[176] and strongly reflected in the outcomes of the Bilateral Aid Review and the Multilateral Aid Review[177]. In January 2011 DFID introduced a new format for programme business plans, with stronger requirements for evaluating the evidence base, cost effectiveness, and commercial viability of proposed interventions. A new Quality Assurance Unit has been established to test programming proposals for analytical rigour and good value for money.

43. The Government also believes that independent scrutiny is essential to help ensure accountability and improve impact and value for money of aid. That is why the Independent Commission for Aid Impact (ICAI) has been set up, to undertake independent evaluation of UK aid and report directly to the International Development Committee of the House of Commons. ICAI will identify approaches that work well or less well, enabling the Government to improve results and value for money.

44. There are a number of ways in which British aid is being made more effective and transparent such as improved guidance on budget support and piloting Cash on Delivery aid.[178] Further, the Government recognises that increased effectiveness by other donors is essential for driving action on results and is working to influence its multilateral partners to improve aid effectiveness and transparency.

45. *Background: Improved guidance on budget support* - In 2010, the Secretary of State approved measures to guide decisions about which countries should receive budget support, and measures to make budget support more effective. Budget support can be the most effective form of development assistance but only in the right circumstances[179] and DFID is reducing the number of countries which will receive budget support in order to better focus our efforts. In considering whether to give budget support, we will place more emphasis on the developing country's commitment to strengthening the accountability between government and its citizens. We are helping recipient country governments do this in a number of ways such as: helping governments improve available data and their own reporting of results; promoting accountability mechanisms; making more use of data generated by citizens and civil society on whether poor people are benefitting from services; and, where appropriate, introducing a payment by results approach where we pay for the results the partner government has achieved.

46. *Cash on Delivery* – COD is a payment-by-results system that links payments more directly to a single specific outcome. This gives the recipient increased authority to achieve progress however it sees fit; and assures that the recipient country's progress is transparent and visible to its own citizens. The UK is funding a few pilot programmes to test this new approach. For example, the Ethiopia pilot will focus on improving access to, and performance in, the grade 10 examinations, especially for girls and children in the poorest

176 http://www.dfid.gov.uk/About-DFID/Finance-and-performance/DFID-Business-plan-2011---2015/
177 http://www.dfid.gov.uk/Media-Room/News-Stories/2011/The-future-of-UK-aid/
178 For more information on COD aid see http://www.cgdev.org/section/initiatives/_active/codaid
179 See, for example, OECD 2006 "A Joint Evaluation of General Budget Support 1994-2004", www.oecd.org/dataoecd/secure/19/46/36442783.pdf

regions of the country. For the next three academic years, the UK will provide more funding to the Ethiopian education system for every *extra* child that sits, and passes, the grade 10 exams over and above the agreed baseline. Because we will only give payment when progress has been achieved and the results are independently verified, UK taxpayers can be confident that their aid has delivered real results. While cash on delivery aid is still in its early stages as an allocation mechanism, it is an innovative way to deliver some development outcomes that increases aid accountability and transparency both in donor and recipient countries and encourages local innovation.

47. *Multilateral influence* - UK leadership is evident in at least three areas: aid effectiveness, transparency and reform of multilateral institutions:

- The UK is leading the world on aid transparency as it believes that increasing the openness and accessibility of information will help reduce the risk of corruption and waste, improve the quality of decision making and increase public accountability. Evidence of the UK's lead in this area includes the establishment of the UK Aid Transparency Guarantee in June 2010, under which the UK now publishes more information than ever before, including the justification for projects funded, the expected results, and financial details of every project transaction over £500. The UK also leads on the International Aid Transparency Initiative with nineteen donors and twenty partner countries having agreed an international standard for aid transparency. In June 2010 the UK became the first country to publish information in line with IATI standards and we continue to urge others to implement it in a timely fashion.

- The Multilateral Aid Review (MAR) is levering reform across the UN system. It has sent a strong signal to the UN leadership and is seen as a catalyst for change. We are working with likeminded donors on specific agencies e.g. with UNICEF and UNDP to improve results reporting and to ensure maximum value for money for the UK's contributions. Other donors, including the US, Australia and the EU, have shown a great deal of interest in the MAR and are using it alongside their own assessments to guide their multilateral engagement strategies.

- 2011 is a key year for improving aid effectiveness and impact. Global development actors will come together at the Fourth High Level Forum (HLF4) on Aid Effectiveness in Busan in November 2011 to take stock of progress and develop plans for the future. In the run up to HLF4 and beyond the UK will work with others to drive fundamental reform of the global aid system to make it more effective, transparent and responsive to the needs of poor people. As part of this preparation for Busan DFID is engaged with the work of various think tanks (including the Brooking's Institution, Overseas Development Institute and the Centre for Global Development), as well as a range of other civil society and private sector organisations to help shape the new development landscape.

THEME 3. AID ALLOCATION [Q6, Q7]

[Question 6] How should aid be allocated? How far do (and should) the Millennium Development Goals shape aid allocations

48. *Summary:* DFID uses an aid allocation process which draws directly on the results that development assistance can achieve in each recipient country. The Bilateral Aid Review

(BAR)[180] sets out the UK approach to allocating its bilateral expenditure. Ultimately these decisions are made by Ministers.

49. DFID's priority bilateral expenditure is directed towards countries where development need is high and there is a high likelihood that development assistance will be effective. The process of narrowing DFID's country focus also took into account the activities of other donors, and in particular noted which countries were receiving high and low levels of aid in per capita terms.[181]

50. To a significant degree the Millennium Development Goals (MDGs) shape aid allocations as they are internationally agreed goals that the UK has made a commitment to help achieve. In the BAR, results which Ministers requested from country teams were grouped around five pillars – wealth creation, governance and security, climate change, humanitarian assistance and direct delivery of MDGs.[182]

51. *Background:* For the BAR, DFID's country offices and regional teams were asked to set out the results that they could deliver in their countries and the consequent cost of delivery. Results offers were closely aligned with the national policy objectives of the relevant country, the plans of other donors and the comparative advantage held by DFID.

52. The BAR allocation model was a fundamental change from the previous method. The previous allocation model was based on a top down process drawing heavily on historical allocations and the definition of need. The new process was built on bottom up results offers where individual countries identified a range of programme that would make the most impact. The results offers were then subject to peer reviews, central scrutiny as well as validation against a Need-Effectiveness index. This index measures need using the number of people living under $2 a day, the country's score on the UN's Human Development Index and a measure of the country's fragility. Effectiveness is measured using the World Bank's Country Policy and Institutional Assessment (CPIA)[183]. A ranking of all 144 Low and Middle Income[184] countries in the world shows that 19 of DFID's 27 priority countries are in the top quartile of the index.[185]

53. The Multilateral Aid Review (MAR) also took a radically new approach to allocating funds[186]. Previously, multilateral funding decisions were made piecemeal on the basis of historic funding levels, burden share, and an assessment of effectiveness. The MAR instead systematically reviewed the value for money for UK aid of spend through all of the multilateral organisations. It did this through an assessment framework which captured all dimensions of value for money, from cost and value consciousness and contribution to results through to the strategic fit with UK objectives, and including the extent to which the organisation focuses on poor countries where results are achievable. This focus on poor

180 para 2, p. 3, Bilateral Aid Review: Technical Report. Available for download at http://www.dfid.gov.uk/aidreviews
181 para 22, p. 7, Bilateral Aid Review: Technical Report
182 Para 24-25, p. 8, Bilateral Aid Review: Technical Report.
183 The Bank's Country Policy and Institutional Assessment (CPIA) assesses the conduciveness of a country's policy and institutional framework to poverty reduction, sustainable growth, and the effective use of development assistance. The CPIA uses 16 criteria are grouped into four clusters—economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. These clusters are weighted equally to derive the overall CPIA rating. For details - siteresources.worldbank.org/EXTCPIA/Resources/cpia_full.pdf
184 Low and Middle Income as defined by the World Bank Analytical Classifications. Country lists available at World Development Indicators Online http://data.worldbank.org/data-catalog/world-development-indicators
185 Annex B, Bilateral Aid Review: Technical Report
186 Annex 1, Multilateral Aid Review – Full Report. Available for download at http://www.dfid.gov.uk/aidreviews

countries where aid is most effective was calculated using the Need-Effectiveness Index outlined above.

54. The MAR assessments were rigorously based on the best available evidence, and subject to a robust process of scrutiny and challenge, including by the directors of the two leading UK think tanks on international development, the Overseas Development Institute and the Institute of Development Studies. On the basis of these assessments, multilateral organisations were classified as offering very good, good, adequate or poor value for money for UK aid. Decisions about funding were made on the basis of these judgements.

55. All 192 member states of the UN and at least 23 international organisations share the commitment to achieve the MDGs.[187] By working together on shared goals we can achieve the sort of strong partnerships with governments, civil society and the private sector in developing countries that is needed to deliver results.

56. In the BAR results were requested from country teams against five pillars – wealth creation, governance and security, climate change, humanitarian assistance and direct delivery of MDGs.[188] Thus, progress towards the MDGs is one of five factors shaping aid allocations but it is recognised that development in a number of different areas is a prerequisite to making sustainable progress on the MDGs. As an illustration of these interdependencies, the most recent MDG review shows that recent food, fuel and financial crises have reversed some achievements or at least slowed progress in some countries.[189]

57. Moreover, while aid is important, it will not be the only factor that will determine whether the MDGs are achieved. Sustainable progress towards the MDGs is possible only if the challenges of macroeconomic stability, insufficient infrastructure, environmental sustainability and climate change and conflict/fragility are tackled. Free trade and access to markets are also critical for underpinning the growth needed to achieve the MDGs, so DFID works closely with the Department for Business, Industry and Skills to promote progress on trade reform through the WTO, regional trade arrangements, and trade facilitation.

[Question 7] How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?

58. *Summary:* The commitment by donor countries to spend 0.7% of their Gross National Income (GNI)[190] on ODA is an important international commitment to the eradication of global poverty. The target was first established in 1970 at the United Nations,[191] six DAC member countries have achieved it already and the EU has a collective commitment to reach 0.7% by 2015.

187 Background page, UN Millennium Development Goals website. http://www.un.org/millenniumgoals/bkgd.shtml
188 Para 24-25, p. 8, Bilateral Aid Review: Technical Report.
189 United Nations Development Programme publication, "Beyond the Midpoint: Achieving the Millennium Development Goals", January 2010. Full report available at http://content.undp.org/go/newsroom/publications/poverty-reduction/poverty-website/mdgs/beyond-the-midpoint.en
190 Gross National Income comprises the total value of goods and services produced within a country, together with its income received from other countries (notably interest and dividends) less similar payments made to other countries. Estimates of UK GNI are produced by the Office of National Statistics as part of the UK National Accounts. These are produced as National Statistics in line with the Code of Practice for Official Statistics.
191 UN General Assembly resolution 2626, "The International Development Strategy for the Second United Nations Development Decade" (25th session), 19 November 1970, paragraph 43.

59. The Coalition Programme for Government reaffirmed the pledge made by the UK Government at the Gleneagles G8 in 2005 to meet the 0.7% target from 2013, and committed to enshrine this commitment in law.[192] The Government has set out its plans to deliver the 0.7% commitment in the Spending Review of 2010.[193]

60. If all OECD–DAC donor countries reached the 0.7% target then around a further US$150 billion per annum will be available to secure development and make progress towards the achievement of the MDGs. More resources are needed to reach the MDGs – for example, the estimated cost for scaling up services for the health of women and children in the 49 lowest-income countries (in 2005 US$ billions) is at least US$14 billion in 2011, rising to US$21 billion by 2015.[194] Evidence shows that low-income countries with good macroeconomic policies are able to use scaled-up aid inflows to enhance overall growth and development (see answer to Question 2).

61. *Background:* Increasing the amount of ODA provided by the UK to 0.7% of GNI will make a difference in two ways. Firstly, it will directly lift people out of poverty and support economic growth. The Government has set out concrete results it expects to deliver over the next four years.[195] Secondly, it will put pressure on other international donors to keep their promises on 0.7%, including at the highest levels through personal interventions by the Prime Minister at the G8 and the European Council, potentially leading to an even more significant increase in the total level of ODA available to developing countries. By contrast, cuts by the UK could have multiplied consequences as it would set a negative example which others could use as an excuse to cut their own programmes.

62. With good macroeconomic management, this increase in funding would not lead to more aid than recipient countries can efficiently absorb (see answer to question 2).[196] All of the additional funding could be put to good use. Costing exercises for the achievement of the MDGs reveal large unmet financing gaps.[197] Apart from the MDGs, there are also unmet financing needs for physical capital investments. For example, the World Bank estimates that the infrastructure financing gap in developing countries is potentially as high as US$ 270 billion per year.

63. The Accra Agenda for Action (AAA) committed donors to "improve allocation of resources across countries" and to "work to address the issues of countries that receive insufficient aid" responding to concerns about the phenomenon of under-aided countries. There are a number of ways to measure whether a country has sufficient aid or not. However, effective absorption requires that the increased aid should be tailored to individual country needs.[198] OECD-DAC has proposed that there should be a "watch list" of potentially under-aided countries. Appearing on the watch list would not imply that aid would automatically be scaled up to these countries but it would signal the need for a careful

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192 The Coalition: Our Programme for Government, 2010

193 p. 60 UK Treasury (2010) Spending Review

194 Background Paper for the Global Strategy for Women and Children's Health, "Financial Estimates in the Global Strategy", United Nations Secretary-General's Global Strategy for Women's and Children's Health, September 2010

195 UK Aid: Changing Lives, Delivering Results

196 E.g. Independent Evaluation Office of the IMF (2007) The IMF and Aid to Sub Sahara Africa; IMF (2005) The Macroeconomics of Managing Increased Aid Inflows: Experiences of Low-Income Countries and Policy Implications.

197 Robert Utz, "Will Countries that Receive Insufficient Aid Please Stand Up", Concessional Finance and Global Partnerships Research Programme on the International Aid Architecture, April 27 2010

198 E.g. François Bourguignon and Mark Sundberg (2006) Absorptive Capacity and Achieving the MDGs. UNU WIDER Research Paper No. 2006/47

look and joint discussion.[199] OECD-DAC's initial work indicates that twenty countries[200] are potentially under-aided, according to two or more criteria. The potentially under-aided countries are to a large extent fragile states, with low institutional policy ratings (*i.e.* Country Policy Institutional Assessment score below 3.2) and lagging behind in achieving the MDGs.

THEME 4. PRIVATE SECTOR AND ODA INTERACTIONS [Q8, Q9, Q11]

[Question 8] Does ODA complement or inhibit private investment in developing countries?

64. *Summary* – the Government believes that a strong private sector in developing countries is a necessary condition for sustainable development and that aid can play a vital role in strengthening and complementing private investment in developing countries. In May 2011, DFID published a new paper: "The Engine of Development – the Private Sector and Prosperity for Poor People"[201] that outlines DFID's new approach to working with the private sector. Whilst there is considerable overlap between them, one can broadly distinguish two categories of intervention; (i) those that engage directly with private enterprises with the aim of, for example stimulating investment or innovation or business development, and (ii) those that aim to improve conditions for successful private investment and business.

65. In the first category, ODA can be used to complement the activities of the private sector by encouraging or "crowding in" private investment. This crowding-in effect has been observed particularly for infrastructure investment.[202] It can also be achieved by sharing risks (e.g. guarantees), facilitating long-term finance and generating more investment opportunities.

66. *Background* – One example of how DFID uses ODA to encourage the work of the private sector is through the work of the Private Infrastructure Development Group (PIDG). PIDG has a portfolio of professionally-run facilities to catalyse private investment in infrastructure. It pioneers investment where the private sector is reluctant to go; mitigating risks and demonstrating that viable, decent returns can be made. Using ODA in smart ways through the PIDG is proving to be remarkably catalytic - $416 million from PIDG members (about half from DFID) has helped secure $14.5 billion of private investment into telecoms, energy and transport projects. These investments are projected to benefit nearly 100 million people in the poorer developing countries. These services will be sustainable as they are run on a commercially viable basis.[203]

67. The second category is where ODA is used to help *create or strengthen the conditions* for private sector growth. ODA can be used to cut unnecessary red tape, institute sensible regulatory regimes or strengthen markets and commercial justice - all activities that reduce the costs and unpredictability of doing business. If successful, these activities would increase

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199 OECD-DAC (2011) Aid Orphans: A Collective Responsibility? Improved Identification and Monitoring of Under-Aided Countries, DCD/DAC 2011/18 27 April.

200 Bangladesh, Chad, Guinea, Madagascar, Niger, Comoros, Eritrea, Gambia, Myanmar, Nepal, Burkina Faso, Burundi, Central African Republic, DRC, Ethiopia, Lesotho, Tajikistan, Togo, Uganda and Zimbabwe.

201 http://www.dfid.gov.uk/Documents/publications1/Private-sector-approach-paper-May2011.pdf

202 See for example Cavallo, E. and Daude, C. "Public Investment in Developing Countries: A Blessing or a Curse?", Journal of Comparative Economics 39 (2011) 65–81 and Lora, E., 2007. "Public Investment in Infrastructure in Latin America: Is Debt the Culprit?" Inter-American Development Bank, Research Department Working Paper 595

203 www.pidg.org

returns to all private investment in a country and incentivise increases in both domestic and foreign private investment. An example of how British ODA has been used to stimulate private sector activity in this way is DFID's funding and support for setting up the Investment Climate Facility for Africa (ICF). The ICF was established in 2007 to remove barriers to investment in Africa. Examples of ICF results to date include reducing the time taken to register a business in Burkina Faso, Rwanda and Mozambique and making progress on easing a number of other types of regulatory burdens on businesses.[204]

68. In Nigeria, where the economy is growing at over eight per cent per annum, but where 100 million of a population of 158 million still live on less than £1 a day, DFID is implementing both approaches. Over the next four years the Secretary of State has decided that Britain's programme will focus on addressing the constraints to doing business and on making focussed interventions to leverage or 'crowd in' the private sector. For example, Nigeria's weak power supply - equivalent to the town of Bradford only - means that 80% of firms say their number one problem is a lack of reliable electricity. DFID has provided technical advice resulting in better planning and use of existing infrastructure. Since 2009, 75% more power has already been supplied and in the next four years DFID technical support will help the government double power supply. This support is complemented by wider efforts to improve the business environment, especially on tax and land reform, and investment promotion. Targeted support to the agriculture, construction, and the meat and leather sectors is focused on removing market barriers. For example, work with a fertiliser company on small packet sales to poor people is being expanded from a pilot in two states, to 26 states, with planned sales this year of 7,500 metric tonnes from zero two years ago. Other fertiliser companies are now replicating the approach in order to enter the market. Together this work will increase the incomes of 600,000 Nigerians by at least a half and encourage significantly more inward investment.

69. As shown by the examples above, DFID only engages with the private sector where ODA can add significant value and complement private investment. This is in accordance with a consensus view[205] that development finance institutions (DFIs) should only make investments that:

- private investors are unwilling or unable to make
- focus on catalytic investments that entice other private investment, especially in the current economic downturn
- DFIs should exit investments once they have achieved the demonstration effect and private investors are ready to supply substitute funds.

[Question 9] How does ODA, and British aid in particular, interact with financial flows from other sources including new donors, such as China, India and Brazil, private capital flows, and philanthropic sources?

70. *Summary* - There has been a dramatic proliferation of new donors including private philanthropic foundations as well as increased private sector activity in developing countries. The British aid programme works closely with many of these new actors and we actively seek out ways to ensure that our work complements their activities. Some examples of

[204] For details see http://www.icfafrica.org/downloads/English/ICF%20Q1%20Project%20Fact%20Sheet.pdf
[205] Sinha, S., Bortes, C. and Grettve, A. "Literature Review of Development Returns to DFIs Investment in Private Enterprises", DFID Report, February 2011

areas where DFID has collaborated with other donors and non-government funders include the work on the Global Alliance for Vaccines and Immunisations (GAVI), provision of anti-malaria and AIDS medications in India, and joint research funding on pharaceuticals and food security with the Bill and Melinda Gates Foundation. A new Global Partnerships Department was established in April 2011 with the explicity purpose of building stronger development partnerships with emerging powers such as Brazil and China.

71. *Background* - In 1970, 75% of recorded aid to poor countries came from the US, UK and France,[206] compared with 44% in 2010[207]. In recent years, we have seen dramatic change - the DAC (Development Assistance Committee of the OECD) now has 24 members and as many affiliates and there are new actors appearing all the time. Key newer players include emerging powers such as the BRICs, private foundations and other non-governmental funders. Not all of those often categorised as "new donors" are actually that new - the Gulf States and institutions have been significant funders of development for decades, while many countries in Asia and Latin America have been providing technical assistance to poorer neighbours - popularly known as South-South Cooperation - for many years.

72. The Secretary of State set out DFID's commitment to working closely with all partners to deliver better results for poor people in a speech at Chatham House in February 2011[208]. There are some very interesting examples already of collaboration with philanthropic foundations and with emerging powers on development. DFID is working with India and the Clinton Foundation to help local businesses in India to improve the availability of low-cost, high-quality drugs for AIDS and malaria across the developing world and Africa in particular. In the Democratic Republic of Congo, we are working in partnership with the DRC Government and China on a large road-building programme, with DFID not just funding part of the physical infrastructure works, but also providing expertise on social and environmental safeguards.

73. We are in the process of building a closer working partnership with the Islamic Development Bank - which spends around US$7.5 billion per annum. For example, we are seconding a DFID staff member to the IDB specifically to work on aid effectiveness and project results to help them deliver maximum impact from their investments.

74. We are also working broadly with the DAC to ensure that the next generation of work on aid effectiveness is built on consensus on the importance of delivering results and involves a full range of new partners (see Paragraph 47 above for more details).

75. One of the highest profile and most successful collaborations is with the Gates Foundation on GAVI, a public private partnership launched in 2000 with a mission is to save children's lives and protect people's health by increasing access to immunisation in poor countries. In June, the UK hosted the GAVI pledging conference, chaired by the Secretary of State, and co-hosted with the Bill and Melinda Gates Foundation and the Liberian Government. We led lobbying efforts, working with existing and new donors, the private sector, philanthropic foundations, civil society and vaccine manufacturers. New funding sources were secured, including Brazil, Korea and Japan as new donors, the Holy See, two

[206] p. 7, Nemat Shafik, "The Future of Aid", Eighth Luca D'Agliano Lecture in Development Economics, Centro Studi Luca D'Agliano, December 2010 www.dagliano.unimi.it/media/Eighth_Lecture_Text.pdf
[207] http://www.oecd.org/dataoecd/54/41/47515917.pdf
[208] Andrew Mitchell "Emerging Powers and the International Development Agenda" http://www.chathamhouse.org.uk/publications/papers/view/-/id/1005/

companies (Anglo American and JP Morgan) and a philanthropic foundation (Absolute Return for Kids) made their first pledge through a new corporate matching fund. Vaccine manufacturers made significant commitments to reduce the cost of vaccines (pentavalent, rotavirus and future vaccines). These efforts cumulated in a successful replenishment, securing US$4.3bn against a target of US3.7bn, which will allow GAVI to immunise over a quarter of a billion children, and save over four million lives over the next five years.

76. An example of how the British aid programme is set up to interact positively with private sector flows is through the work of a significantly reformed and reinvigorated CDC, which is owned by the UK Government. CDC has an independent board and operates on a commercial basis, working within defined investment policy targets set by the Secretary of State and a clear Investment Code around Environmental, Social and Governance standards. The new high level business plan of CDC states our commitment to ensuring that its capital flows reach the poorest countries. CDC's mission is "to be a pioneering investor, stimulating the private sector and demonstrating the power of enterprise and private capital to reduce poverty in the poorest places of the world".[209] Through DFID's arms length relationship with CDC we aim to create a demonstration effect of the opportunities for investment in developing countries which will encourage private capital flows to follow.

[Question 11] What are the prospects for using aid for market-based initiatives, for example in providing insurance against earthquake damage?

77. *Summary* - The Government is committed to harnessing the power of the private sector to achieve development objectives. Market based initiatives complement DFID's work because they can offer more responsive, flexible and dynamic solutions to development problems than state or international actors. DFID uses aid to support market-based initiatives to support insurance against natural disasters and in a number of other areas such as public health, combating climate change and facilitating commodity markets.

Insurance

78. DFID is piloting a range of micro and macro insurance models which vary significantly with respect to their impacts on the poorest people. Macro-level insurance tends to be spent by governments on immediate Disaster Relief and Reduction activities and is also the first insurance instrument to successfully develop parametric policies[210] backed by both traditional and capital markets. Meso level insurance products support small organisations such as micro-credit organisations and provide support mainly to farmers who fail to pay interest on loans as a result of climate and weather impacts. There already exists a market for weather insurance in developing countries, albeit limited to small areas and pilots.

79. One macro insurance mechanism for climate purposes which DFID funds is the Caribbean Catastrophe Risk Insurance Facility (CCRIF) which has the limited objective of providing emergency liquidity. The CCRIF acts as a financial intermediary between the participating countries and the international re-insurance market to allow participating governments to pool their risks and hence lower and stabilize the cost of coverage. We are also exploring other potential models (especially micro insurance models) which build long

[209] For further information see http://www.cdcgroup.com/

[210] Parametric insurance is insurance based on a set of parameters which get monitored and against which payments are triggered e.g. a 5% fall in precipitation etc.

term resilience of the poor by strengthening their capacity to accumulate assets and protect their assets during extreme events.

Public Health

80. The International Finance Facility for Immunization (IFFIm) is a financing mechanism that raises funds for GAVI programmes by issuing bonds (borrowing) in the capital market. These bonds are paid back by long-term pledges from donors. Since 2006, IFFIm has raised US$ 3.4 billion from institutional and individual investors. Between 2006 and 2010 over half of the funding for the Global Alliance for Vaccines and Immunization came from IFFIm, enabling GAVI to double in size to become a major player in global health. In doing so IFFIm has helped GAVI to save over three million lives.[211]

81. GAVI has also pioneered the use of Advanced Market Commitments (AMCs). In an AMC, donor funding is used to guarantee the price and market size of future vaccines.[212] These commitments provide manufacturers with the incentive they need to develop and sustain the supply of new drugs. The AMC pays only on delivery, so vaccine manufacturers must deliver approved vaccines at the appropriate price before donors pay out. Previously private companies have not invested enough in developing and producing the vaccines needed in poor countries because developing country markets were seen as too small and unpredictable. This has meant vaccines are either not produced or take a very long time to reach the market. By reducing the level of uncertainty in the market, an AMC stimulates private sector investment while ensuring that essential vaccines reach consumers in developing countries at affordable prices. Currently, GAVI is piloting the use of AMCs to raise funding for vaccination against pneumoccocal disease. The pilot programme aims to vaccinate 90 million children against pneumococcal disease by 2015.[213]

Combating Climate Change

82. Some examples of how aid is being used to stimulate market based solutions to address the challenges of climate change are:

- DFID has a Business Innovation Facility that supports companies that are developing inclusive business projects. The Facility helps these companies to broker partnerships and get set up in business. It helps locate financial support, and in some cases, shares the cost of consultancy.[214] The Facility is supporting a project run by two companies in Nigeria to enable low income households to replace existing polluting solid fuel stoves with clean burning gas cylinder stoves. The stoves will be made affordable with microfinance credit to cover the upfront cost. The project will reduce black carbon

[211] For details on IFFIm see http://www.iffim.org/

[212] In the case of the GAV[212] parametric insurance is insurance which is based on a set of parameters which get monitored...against which payments are triggered....a 5% fall in precipitation etc

[212] For details on IFFIm see http://www.iffim.org/I pilot scheme of the pneumococcal vaccine AMC, Manufacturers sign ten year supply agreements which specify a long term 'tail price' for the drugs – in the current pilot for pneumococcal vaccines this 'tail price' is a 95% reduction on current prices in the US market. As part of this agreement donors commit to pay manufacturers a higher price for the first 20% of doses. Donor funding provides a $3.50 subsidy per dose for around the first 20% of doses supplied under the AMC – doubling the price per dose to $7. p. 8, "Advanced Market Commitment for Pneumococcal Vaccines", Annual Report April 2010 to March 2011. http://www.vaccineamc.org/AMCannualReport11.html

[213] p. 25 AMC Annual Report 2011

[214] For more information http://www.dfid.gov.uk/About-DFID/Who-we-work-with/Business/Business-Innovation-Facility/

dioxide emissions, and levels of deforestation, whilst improving the air quality within homes[215].

- To stimulate local innovation, the £10 million REACT Challenge Fund in East Africa holds a competition for grants open to local businesses wanting to develop innovative commercial projects in renewable energy and climate change adaptation technology. Grants awarded are matched to the value of resources that the business will invest in these new enterprises.
- DFID in collaboration with Norway is supporting Green Africa Power, which plans to buy power from renewable energy producers through long-term power purchase agreements. The aim is to provide electricity for up to 3.3 million households by 2015, as well as avoid emissions of up to 909,000 tonnes of CO2 equivalent per year. The programme will use an Advance Market Commitment model to raise revenue (see above for details on how AMCs work).

Ethiopia Commodity Exchange[216]

83. Another effective use of development assistance to support a market-based initiative is seen in the Ethiopia Commodity Exchange project. The Ethiopia Commodity Exchange (ECX) is a marketplace where buyers and sellers come together to trade on the basis of assured quality, delivery and payment. The ECX is now the main trading platform for coffee (Ethiopia's main export), sesame, haricot beans, maize and wheat. ECX's mission is to connect all buyers and sellers in an efficient, reliable, and transparent market by harnessing innovation and technology, and based on continuous learning, fairness, and commitment to excellence.

84. The Ethiopia Commodity Exchange (ECX) commenced trading operations in April 2008. Much of the design for the ECX was provided by a DFID supported project - the Ethiopia Strategic Support Programme implemented by the Ethiopia Development Research Institute and the International Food Policy Research Institute (IFPRI) dating back to 2005.

85. The Exchange employs 600 people and has traded more than $1 billion of commodities since 2008, involving the grading, handling, storing, trading, and delivery of 4.6 million bags, participation by 450 members and their 6000 clients, and 20,000 market information phone inquiries a day.

86. The ECX is one of the first of its kind in Africa and has hosted study tours from around Africa and beyond. The vision of ECX is to revolutionize Ethiopia's tradition bound agriculture by creating a new marketplace that serves all market actors, from farmers to traders to processors to exporters to consumers. The ECX is a unique partnership between market actors, the Members of the Exchange, and its main promoter, the Government of Ethiopia.

THEME 5. FRAGILE STATES AND SECURITY [Q10]

[Question 10] How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

[215] p.23, "The Engine of Development: The Private Sector and Prosperity for Poor People", DFID publication, May 2011, http://www.dfid.gov.uk/Documents/publications1/Private-sector-approach-paper-May2011.pdf

[216] For details on the Ethiopia Commodity Exchange visit: www.ecx.com.et and for more information on the Ethiopia Strategic Support Program please visit : http://www.ifpri.org/book-757/ourwork/program/ethiopia-strategy-support-program

87. *Summary:* The Government has given a far greater priority to tackling conflict in the poorest countries because we realise that conflict and instability are key determinants of poverty. Every country requires a different approach, but UK aid can help to build peaceful states and societies by:

- Addressing the underlying causes of conflict and fragility
- Supporting conflict resolution mechanisms
- Supporting inclusive political settlements and inclusive political systems
- Developing core state functions - such as security, justice, finance, and macroeconomic management
- Responding to public expectations - such as for jobs and basic services.

88. By 2014/15, 30 percent of UK aid will be spent in fragile and conflict affected states to address the causes of conflict and lay the foundations for peace. The BAR names our 27 priority countries, twenty of which are classified as fragile states, and sets out some of the results we want to deliver in these countries. The UK is supporting peace building, security and social service delivery in fragile states such as Pakistan, Somalia, Southern Sudan and Yemen.

89. *Background*: The World Bank's *World Development Report 2011, Conflict, Security and Development (WDR 2011)*[217], which this Government specifically pressed for, emphasises that to restore confidence and help break cycles of violence, international actors should: (i) invest in prevention through citizen security, justice and jobs; (ii) support internal agency reforms to provide faster assistance for confidence-building and longer term institutional engagement; (iii) act at the regional level on external stresses; and, (iv) marshal the knowledge and resources of low, middle, and high-income countries.[218]

90. Conflict and fragility present some of the most urgent challenges facing the developing world. WDR 2011 states that 1.5 billion people live in countries affected by repeated cycles of political and criminal violence. On average, a country experiencing an episode of major violence between 1981 and 2005 had a poverty rate 21 percentage points higher than a country that saw no violence.[219] No low income fragile state has yet achieved an MDG and few if any are expected to meet the targets by 2015.[220]

91. The Government has put development at the heart of an integrated approach to fragile states that brings together development, defence and diplomatic resources to support conflict prevention and poverty reduction. The Secretary of State for International Development sits on the National Security Council. The Strategic Defence and Security Review (SDSR) commits us to directing more of our ODA to support conflict affected and fragile states and increasing our investments in upstream prevention.

92. The forthcoming cross-government Building Stability Overseas Strategy will set clear directions for achieving the Coalition Government's objectives. We are strengthening our systems for early warning and horizon-scanning. We will systematically review UK activity,

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217 World Development Report 2011 (WDR 2011): Conflict, Security and Development, World Bank http://wdr2011.worldbank.org/fulltext
218 For further details on these four key actions see Chapter 9 of WDR 2011
219 p.60 WDR 2011
220 P.62-63, WDR 2011

including our development efforts, in those countries where the risks are high and our interests are greatest.

93. The Government will increase the size of the tri-Departmental Conflict Prevention Pool from £229m in 10/11 to £309m in 14/15 and will develop multi-year conflict prevention and stabilisation programmes. A stronger results framework and enhanced operational management systems are being put in place.

94. The MAR has identified key areas in which the work of multilaterals like the EU, UN and World Bank could be strengthened in fragile states. We are identifying where and how we can work better through the UN, EU, World Bank, IMF and NATO on conflict prevention and crisis management.

July 2011

Annex 1: Problems of attribution.

1. One of the reasons why it is not always straightforward to attribute a particular result to a specific aid intervention is that we need to identify the counterfactual – what would have happened in the absence of the intervention? The recent shift to the use of randomised control trials (RCTs) to identify effective policy interventions provides one solution to this problem – the counterfactual is defined by what happens in a control site which is as similar as possible to the so-called treatment site, but in which the intervention does not take place. Well-conducted RCTs deliver strong results for small-scale, narrowly targeted interventions, particularly in sectors where results can be expected to be observed relatively quickly (e.g. health interventions such as de-worming children, mosquito nets or ante and post-natal care). However, their applicability is not universal: they are not well suited to assessing the impact of broader interventions where success can take different forms and may be delivered over a longer time frame (e.g. interventions to strengthen accountability and transparency of the government's budget, to secure macro-economic stability or to combat climate change); the ability to generalise the results beyond the *actual* experiment conducted is often limited (in technical terms, they may have limited external validity) and, even if an RCT proves that an intervention has been effective, we still need to show that aid was necessary for it to be undertaken.

2. The transmission mechanisms by which aid can affect outcomes can be direct or indirect, can take place over various time horizons and can be conditional on a variety of other characteristics (e.g. good rule of law and strong institutions, political and social stability) or other interventions taking place (e.g. reform to customs or excise, improved access to finance). There are different ways of trying to make sense of this complexity, each with its own assumptions, explicit or implicit, and data requirements, and the conclusions of any study can be sensitive to the choices made. Hence, an understanding of the technical underpinning of the research is an important aspect of assessing the evidence on results and the degree of faith we should have in their attribution to a particular cause. This is an area where the Government is channelling effort and resources as part of a greatly strengthened approach to evidence based results.

3. A concern sometimes separately expressed about aid is so-called fungibility – the worry that if donors fund project X this just allows the government to shift its funding to

project Y, so that, in fact, it is effectively Y that the aid has bought. But recent evidence has suggested that while such shifts do occur they are not particularly large, so that to a reasonable extent aid does increase expenditure in the areas to which it is targeted.[221]

4. Nor should it be forgotten that problems of attribution and precision pervade the evaluation of all public expenditure. Even in the UK, where we have strong statistical systems, many skilled professionals to conduct research and deep pockets to fund evaluations, estimates of the impact of government spending on economic growth are uncertain and speculative. For example, a recent PAC report found that the number of additional jobs created by initiatives to increase employment in former coalfield communities was uncertain because the public money might have been invested in jobs that would have been created anyway.[222]

Annex 2. South Korea and Botswana

1. The examples of two countries, Republic of Korea and Botswana, illustrate the lessons we can learn from aid graduates. They both highlight the role of investment in human capital and infrastructure, effective institutions and government policies that promote exports and encourage the private sector.

Republic of Korea[223]

2. To promote development, the government of Korea and the private sector made joint efforts to address innovation and coordination externalities. The government shared the investment risks of the private sector and provided support largely based on performance in competitive global markets. The reinforcement of successful experiments through the feedback mechanism of performance-based rewards led to dramatic changes over time. An important feature of this experimental approach was the government's willingness to discontinue projects that were failing.

3. International trade helped Korea to discover its comparative advantages, overcome the limits of its small domestic market and exploit scale economies. While relying on global markets, Korea made conscious and concerted efforts to move into higher value-added areas along the value chain by making complementary investments in human capital and infrastructure.

4. Perhaps the most salient feature of Korea's growth story is this emphasis placed on human capital and infrastructure. Although Korea was one of the poorest countries in the world in the 1950s, it invested its limited resources to promote universal primary education. Investing in people by itself was not enough to promote growth in the absence of complementary industrial and trade developments, but it provided the basis for Korea's initial takeoff in the 1960s. Between the early 1960s and the 1980s, Korea made infrastructure investment in a priority. It experienced a dramatic increase in its electricity

221 See, for example, Nicolas Van de Sijpe (2010) 'Is foreign aid fungible? Evidence from the education and health sectors', 2010, University of Oxford, Department of Economics, Centre for the Study of African Economies (CSAE), Working Paper WPS/2010-38.or van de Walle, D. and Mu, R. (2007) 'Fungibility and the flypaper effect of project aid: micro-evidence for Vietnam'. Journal of Development Economics, 84(2), pp. 667–685.
222 Public Accounts Committee 'Regenerating the English Coalfields – Summary', Prepared 10 March 2010;.
223 Based on Annex 2, "Economic Growth in Low Income Countries: How the G20 Can Help to Raise and Sustain it", Korea Development Institute, November 2010.

production capacity and also made massive investments in highways and ports to support export oriented industrialisation policies and in multi-purpose dams and water infrastructure to promote agricultural and social development. In the 1970s, as a part of its heavy and chemical industry (HCI) drive, Korea enacted the Industrial Complex Development Promotion Law and provided essential infrastructure such as water, electricity, and transportation.

5. The Republic of Korea received massive amounts of US foreign aid—$12.7 billion between 1945 and 1975 (more than $50 billion in 1998 dollars). Virtually all aid was in grants, roughly equally divided between economic and military aid. Aid was extremely large relative to the size of the Korean economy, averaging 8.1 percent of GDP during 1953–62. Studies on the role of US aid in Korea argue that it was necessary for the Republic of Korea's survival as an independent state in the years before and after the Korean War.[224]

6. Aid contributed to Korea's future economic growth by providing infrastructure investment and technical assistance. US assistance also helped Korea to recover from the war and rebuild as quickly as it did. The large amount of infrastructure construction—power systems, railroads, and port capacity —that the US financed probably permitted faster economic growth in future years than otherwise would have been possible.[225]

7. Until the early 1960s, USAID was the only significant aid donor to Korea. From 1962 to 1984, the World Bank provided provided $5.259 billion (1997 dollars). The Asian Development Bank (ADB) has provided $1,377 billion since 1968, when its program began. Both banks made major investments in infrastructure, especially transportation and both provided funds to Korean banks and institutions for relending to industry.[226]

Botswana

8. Botswana was one of the poorest countries in the world at the time of its independence in 1966 and relied on grants-in-aid from Britain for most of its development spending and recurrent budget.[227] It has since sustained an economic growth rate that is one of the highest in the world, is a middle income country and is largely considered to have graduated from aid.

9. Botswana's success is generally credited to a number of factors:

a) Natural resources - it has the two largest and most lucrative diamond mines in the world, which continue to contribute nearly 40% of government revenues.
b) Social and political stability – Botswana has enjoyed successive free and fair elections since 1965 with no significant change in power. Some criticise Botswana's democratic credentials as more formal than ideal but this stability and social cohesion contrasts strongly with many developing African countries.

[224] Fox. J "Republic of Korea: The Making of a Miracle", Chapter 3 in *Appling the Comprehensive Development Framework to USAID Experiences*, World Bank Operations Evaluation Department, Summer 2000

[116] p.21 "The Role of Foreign Aid in Development: South Korea and the Philippines", Congressional Budget Office Memorandum, September 1997

[226] p. 32 USAID Evaluation Study no. 42, "Foreign Aid and the Development of the Republic of Korea: The Effectiveness of Concessional Assistance", December 1985

[227] Maipose, G., Somolekae, G. and Johnston,T "Effective Aid Management: The Case of Botswana", in Carlsson, J. Somolekae,G. and Van de Walle, N. *Foreign Aid in Africa: Learning from Country Experiences*, Nordiska Afrikainstitutet, Uppsala 1997

c) Good judgement – when the diamond revenues did begin to flow, the revenues were generally well used. Emphasis was placed on investment in public and social infrastructure (roads, healthcare and education). The economic policies that were adopted were largely favourable to the private sector and foreign investment.[228]
d) Development of the non-mining sector economy – there has been job growth in Botswana in sectors dependent upon government or other forms of domestic consumption. This non-mining growth has been an important phenomenon during the 1990s and 2000s.
e) Effective management of development assistance - Botswana is unique among African countries in the extent to which aid resources have been centrally managed and fully integrated into a national development planning and budgeting process.[229]

10. While these factors are the proximate bases of Botswana's success, most studies point to the crucial underpinning provided by good political institutions which led to the adoption of good economic policies.[230]

11. There are some caveats to the positive story on Botswana's growth. As mentioned earlier, job growth in non-mining sectors has taken place only in sectors dependent on government or domestic consumption but not in other export-oriented manufacturing or low-wage sectors. As a result, Botswana still has high levels of un- or under-employment (estimated at some 25% of the potential workforce). It also has one of the highest rates of income disparity in the world as measured by the Gini coefficient. Finally, HIV/AIDs touches every sector of society - Botswana's national prevalence remains just over 17%. However Botswana was one of the first countries in Africa to introduce free, country-wide provision of antiretrovirals (ARVs) which should help prevent new infections and lower the rate of infant and other HIV/AIDS related mortality.[231]

12. Despite these caveats, the story of economic development and growth in Botswana, much like the Republic of Korea, shows the importance of good governance, partnerships with the private sector and investment in infrastructure and human capital.

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228 information from British High Commission of Botswana.
229 Maipose, G. Somolekae,G. and Johnston, T. 1997
230 Robinson, A.J. "Botswana as a Role Model for Country Success", UNU-WIDER Research Paper no. 2009/40. Acemoglu, Daron; Simon Johnson and James Robinson (2003): "An African Success Story: Botswana,", in Dani Rodrik (ed.), *In Search of Prosperity: Analytic Narratives on Economic Growth*, Princeton; Princeton University Press.
231 information from British High Commission of Botswana.

Andrew Mitchell MP, Secretary of State, Department for International Development—Written evidence

Letter dated 3 August 2011.

Department for International Development—Oral evidence (QQ 122-168)

Evidence Session No. 5. *Heard in Public.* *Questions 122 - 168*

TUESDAY 19 JULY 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Forsyth of Drumlean
Lord Lawson of Blaby
Lord Lipsey
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Witnesses: **Michael Anderson**, Director-General, Policy and Global Issues, Department for International Development, **Richard Calvert**, Director, General Finance and Corporate Performance, Department for International Development, and **Rachel Turner**, Director, International Finance Division, Department for International Development.

Q122 The Chairman: Welcome to the Economic Affairs Committee. My apologies for starting a little late; we had one or two matters of some urgency to discuss. We have slightly fewer Members of the Committee here than usual, which reflects the fact that we are about to retire for the Recess. Thank you for coming. This is the fifth public hearing of our inquiry into the economic impact and effectiveness of development aid. We are very grateful to have three distinguished witnesses from DFID here today. Thank you for your written evidence. I would be grateful if you would speak loudly and clearly for the webcast and the shorthand writer. Most of our questions could be answered by all of you but if you agree with the first answer, please do not feel the need to supplement it unless you have something different to say. Would anyone like to make an opening statement?

Michael Anderson: I would, please. Thank you for the opportunity to answer questions on the impact of aid. This is a central concern for DFID officials and has been for some years. In the past year, the Secretary of State for International Development has introduced several changes to how we deliver aid, which are explicitly designed to ensure that UK aid achieves the greatest possible results for the money. Just this morning, the Prime Minister has been talking in Nigeria about the impact and value of aid as a matter of concern at the highest level. At DFID we actively welcome the chance to explain the impact of aid to Parliament and UK taxpayers; it is a fundamental part of making aid better.

With the Chairman's permission, I should quickly like to make three observations. First, at DFID we are working on several fronts to build more effective delivery of aid. Aid programmes can be either well designed, well managed and highly effective or based on a poor understanding of context, badly designed and badly managed. Over the past year the Secretary of State for International Development has initiated a whole series of reforms, which DFID has now introduced to maximise the impact of UK aid. At the risk of testing your patience, I shall quickly list them since they did not feature in our written evidence. There are seven of them.

First, the new Independent Commission for Aid Impact has been established to review, completely independently, the impact and value for money of UK aid programmes. It will report to Parliament, rather than to the department.

Secondly, the department has conducted two major root-and-branch reviews of DFID's programmes—the Bilateral Aid Review and the Multilateral Aid Review. Both scrutinised the aid programmes from first principles with a view to maximising results and value for money. It is fair to say that DFID has never had such a thoroughgoing examination of its entire aid programme as it has had this last year.

Thirdly, under the new UK aid transparency guarantee, DFID is publishing comprehensive, accessible, accurate and timely information about all its aid programmes. This is to promote external scrutiny and accountability and, we hope, a conversation about how aid is being used.

Fourthly, we have introduced a new business case format, which requires much stronger specification of the anticipated results of our programmes and a much stronger economic appraisal before any programme is approved.

Fifthly, we have introduced new systematic reviews of evidence, looking at evidence from around the world and what we are doing. This is to ensure that we have the most up-to-date and complete assessment of the evidence of what works and what does not work in aid project design, not only in DFID but among other donors. It is now a requirement to reflect those judgments in every business case that comes for approval.

Sixthly, based on the findings of the Security and Defence Review and the independent Humanitarian and Emergency Response Review, DFID is refreshing its staffing, skills and structures to improve the impact of its programmes in conflict-affected areas and in humanitarian response.

Seventhly, we have substantially scaled up the volume and rigour of project evaluations in the past year, including drawing on a much larger group of experts in evaluation, whom we have recruited to the organisation to strengthen that component. Those are all things that we have done in the past year to improve the quality of delivery of aid.

My second observation is that while the common goal of UK aid is to transform the lives of poor people, aid is nevertheless a diverse category of activity rather than a single thing. It takes many forms of delivery—technical policy advice, sustained help with government implementation, loans and grants to government, debt reduction, research scholarships, training, multi-donor trust funds, investments in business and so on. It is a heterogeneous category of activities. In looking at assessing them all, one has to bear that in mind. Some aid goes directly to commodities and services—for example, UK support for the Global Alliance for Vaccines and Immunisation, which will save an estimated 1.4 million lives in the next five years. Some aid is targeted on strategic investments in the private sector, such as the mobile banking system M-Pesa in Kenya and so on. These all differ in their impact and present different methodological challenges.

That leads to my third observation, which is that some of the evidence before you from previous testimony referred to the micro/macro paradox of aid. The simple point is that there is a wealth of information and good evidence on the positive economic impacts of particular aid projects at the micro level. With increasing use of more rigorous impact assessment, we have far more precise information about what works. However, the more difficult question arises at the macro level. That is simply because of the methodological problems; there are so many variables to hold in one place. We think that Finn Tarp, whose work has come before this Committee, probably represents the high water mark in that literature. It is the most recent and the most comprehensive. He has been very careful and thorough. On the basis of his evidence—he concludes from 68 major studies—it is clear that aid does not have overall negative impacts on growth. He finds that, on balance, there are positive implications for growth. However, the methodological problems are serious. Because of that, Lord Chairman, we are very focused—although we pay attention to the macro issues—on making sure that the results and value for money of each intervention that DFID conducts are maximised. We are working very hard on that.

Q123 The Chairman: Thank you for that. You have in quite large part answered the first question that I was going to ask you. Let me put it to you nevertheless. Could you briefly describe the aims of DFID's development and assistance programme? Is there anything that you want to add to what you have already said on that—how you see its impact on development in recipient countries, for example? More particularly, in light of your opening statement, how big is the change in culture and direction? Has it really all happened in the past year? Why were many of the points that you have just made not major features previously?

Michael Anderson: I shall ask my colleague Richard Calvert to address the second point on the size of the cultural change in a moment. On the main aims of DFID's programmes, it must be borne in mind that DFID accounts for some 87% of UK ODA. Another proportion of overseas development assistance is spent not by DFID but by other government departments, including DECC, the FCO and so on. The DFID programme is very much regulated by the 2002 Act, which make poverty reduction the primary purpose of our interventions. That is the overarching purpose of British development assistance under DFID. The four priorities of British aid, as outlined in the DFID business plan for the next four years, are, first, to boost wealth creation, especially through private sector investment and promoting trade; secondly, to strengthen governance and security in fragile states and conflict-affected areas; thirdly, to improve the lives of girls and women; and fourthly, to combat the effects of climate change. Those are the major headlines in the business plan. There are also a number of subsets within that, including programmes specifically designed to achieve the millennium development goals. The ultimate aim for DFID is to exit—for there to be no need for aid, other than humanitarian assistance. Our ultimate goal is that DFID should cease to be necessary, but we are a long way from that.

On how impact is measured, I have already said something about the micro and macro levels. I can give more detail on particular projects. There are two examples of impact that I would flag. One is on growth. The Center for Global Development, a Washington-based think tank and probably the most respected of all the think tanks on development, has recently identified 17 African countries that have sustained overall GDP growth exceeding 5% a year between 1996 and 2008. In historical terms, that is a very impressive achievement for Africa. Those countries include Ethiopia, Uganda, Rwanda, Tanzania, Mozambique, Zambia and Ghana, which are all target countries for us. We take that as a good message about overall direction.

On public health, I give you the example of Bangladesh, which has been a star performer. Life expectancy at birth has increased dramatically. A baby born in 1970 could expect to live until the age of only 44, whereas a newborn in 2008 can expect to live to 66. Immunisation cover has increased from 1% of the population to 89%. In comparative historical terms, these are remarkable changes over a very short period.

Richard Calvert: Perhaps I can add a few points on the change in culture. The short answer is that there has been a very big change in culture. That is not to say that before the election DFID did not care about results or value for money. However, the approach in those areas has become much more systematic and rigorous. Some of the things that we were doing well in some areas in the past are now being done much more systematically. The challenge on us is much greater. I shall quickly highlight three points to illustrate that. The first is to do with how aid is allocated. Under our previous systems we would typically look at individual countries and say, "What does an assessment of need tell us ought to be the right level of aid for that country?" Then we would think about how to spend and allocate the money. The process under the bilateral aid review starts with results. Essentially, we have challenged all our country offices by saying, "What results can you deliver?" and asking them to demonstrate those and show how they can be measured. We then decide whether to put the money into that. We start with results, rather than with a level of spending.

Secondly, we have been much more rigorous in how we design projects. Michael said a little about this in his opening statement. Essentially, we have changed our processes, investment cases and programme and project management so that we put value for money and results much more rigorously and systematically into the process.

The last point that I would make, which in many ways goes to the heart of the current context of the debate about aid effectiveness, is that we have a much stronger focus on transparency and accountability to taxpayers. One of the things that this Government have been very clear about in the aid area is that we should be entirely transparent about what we do by publishing on our website all our project documentation for new activities and details of all our spend. That transparency and the fact that when people prepare documentation and run projects they know that it is, effectively, in the public domain are a big driver of cultural change in an organisation.

Q124 The Chairman: So there really is quite a cultural change—a change in direction. How far ahead of other countries are we? Are they following our lead or doing the same things?

Richard Calvert: It is true to say that across the donor community there is a stronger focus on results generally. That partly reflects some of the factors that are in play in the UK. There is pressure on public spending in many donor countries. There is a sense that aid needs to show that it works to justify public spending. It is also fair to say that DFID has followed that logic a little more quickly and systematically than others. If we look at the discussions that we and Ministers have with other donors, many people are looking at the experience of the UK Government and DFID. They do not necessarily follow everything that we do, but we are certainly seen as one of the organisations at the front of the pack in embedding results, value for money and transparency in its work.

Q125 Lord Forsyth of Drumlean: If there is this change of culture, which is very welcome, with an emphasis on outputs rather than inputs, would it not be sensible to apply that to the whole idea of having targets as a percentage of GDP—which is about inputs—as opposed to having targets and objectives that are more related to outputs, achievements and tackling poverty and deprivation?

Richard Calvert: Clearly, judgments about the overall level of aid spending are not purely technical. Equally, if you look at the history of the 0.7% target and its continued relevance and restatement, much of it is based on quite hard-nosed analysis of the financing gap between current levels of aid and what would be required to meet the MDGs. Underneath the 0.7% target, particularly its reinforcement over the past 10 years, has been an understanding of the link between aid volumes and aid requirements.

Q126 Lord Forsyth of Drumlean: I understand that but I am making a point about the culture. If you are setting targets that are about inputs and volumes of money, is that not countercultural in view of what you have just described as being the philosophy of the department?

Richard Calvert: It depends very much on how you apply it in the department. Within the department, we have a programme that is rising to reach 0.7% from 2013 onwards. In the department, it absolutely does not feel as though the primary purpose is to spend the money. In the department, the focus is absolutely on the results that we can achieve with that. Whatever level of spending we have through the spending review period, leading up to 0.7% of GDP from 2013, the department approaches that very much on the basis of how we can maximise the results and value delivered with a given volume of money.

The Chairman: We shall come back to 0.7% later. For now we shall stay with the point about its effect on the change of culture.

Q127 Lord Lawson of Blaby: On the 0.7%, in answer to Lord Forsyth, you mentioned aid requirements to meet the millennium development goals. May I put it to you that that is a complete nonsense? You have not the faintest idea what the aid requirement is. You think that all the research and studies that have been done suggest that, on balance, at a macro level, aid has a positive effect. That is what your colleague, the first of our witnesses said. However, you do not know how big an effect that is. To talk about aid requirements is a complete nonsense, isn't it? How do you measure aid requirements?

Richard Calvert: The MDGs set out a level of basic service provision and a set of other targets on which it is possible to put a financial value—what we estimate it would cost in the poorest countries to provide those. No one would say that that is a figure about which there is absolute precision, but it is nevertheless possible to look for examples, such as the Millennium Development Goal on maternal and child health. We can look at the countries that are off track with that and make estimates about the cost of investment in the health systems of those countries to enable the goal to be achieved.

Q128 Lord Lawson of Blaby: The most important of the millennium development goals is probably the elimination of poverty. That depends largely on economic growth in the countries concerned. You have no idea of the relationship between aid and economic growth. I put it to you that the concept of aid requirement is meaningless.

Michael Anderson: One of the targets, MDG1, is about people having sufficient income—coming out of poverty and not being hungry. There are several targets underneath that. It is true that income per capita is one of more than a dozen targets under the Millennium Development Goals. The other goals are much easier to cost. Provision of schooling, access of girls to school, infant and maternal mortality—it is easier to cost the total investment required to achieve these goals in a period of time. There is a range of debates about that. There are fairly robust debates in the academic community, but there is a range of acceptable answers on those.

The question about growth goes back to the central question of the impact of aid on growth and the exogenous variables that might be affecting it. It is absolutely right to say that several things other than aid influence growth. While we can say with some precision that this much aid is required to achieve maternal mortality reduction, schooling and so on, the question of growth is affected by a variety of factors.

Q129 Lord Lawson of Blaby: At some point I should like to ask supplementary questions arising from the long initial statement by our first witness. Do you think there are any adverse effects of aid? If so, what are they?

Michael Anderson: I shall start and then ask Rachel to come in on some of the points. Some of your previous witnesses gave evidence of examples where aid does harm. That has been asserted. In any large enterprise, there must be a small number of cases where a project has been badly designed or badly implemented, or where some negative effects arise. The significance of the work by Finn Tarp and several others is that, on aggregate, we are reasonably certain that aid does not detract from growth. If you are serious about analysing this with any degree of thoroughness, there is just no evidence that consistent amounts of aid detract from growth. There is some evidence that it contributes to growth. I do not think that the casual arguments about aid undermining growth in Africa stand up to any serious academic scrutiny of the numbers. There are some questions about the so-called Dutch effect, which I shall leave for Rachel to talk about.

Rachel Turner: It is true that around Gleneagles, around 2000 and 2001, many commentators said that a large surge in aid would be damaging because it would push up exchange rates. As Michael said, that very much picked up the kind of Dutch disease experience from countries in Europe. The IMF itself around that time looked at the issue very carefully and has followed it very carefully since. What we have seen is that countries that have experienced large surges of aid have not experienced exchange rate appreciation. We have not seen those so-called Dutch disease effects. That seems to be very much because there is productive space in the economy. We were spending aid well, collectively, and aid was increasing productivity in those countries, allowing them to produce in response to the aid, rather than just driving up prices. Of course it also goes to how well the macroeconomy was managed. The examples of countries that Michael gave earlier, such as Mozambique, where we saw big surges in aid after the war, show that it is possible for aid to have a positive effect. Many of those earlier negative assumptions about large surges in aid flows have not proved to be true.

Q130 Lord Lawson of Blaby: I agree with you. Of all the adverse effects of aid, that is probably the least important and the biggest red herring. I put it to you that among the bigger problems—I would be interested in your comments on this—are, first, the fact that aid and corruption so frequently go hand in hand, which is extremely damaging, and, secondly, aid dependency. I should like to draw an analogy. It struck me, before the Government of which I was a part came into office in 1979, that the quality of British management was extremely poor. That was because a culture had grown up in which businessmen thought it was more important to try to get grants of one kind or another from the Government than to run their own businesses efficiently. That was the society that they were living in. I am saying something about human nature, not about the people who live in the developing world. I believe that there is considerable evidence that you see this in spades in the developing world with aid. There are other problems, too. For example, most aid is Government to Government, yet it is accepted by DFID that the private sector is the key to growth. There is a real problem and a real tension there. These seem to me—I should like your views on this—to be much more problematic than the so-called Dutch disease.

The Chairman: We will come back to corruption, so could you just answer on the other points? We shall deal with corruption separately.

Michael Anderson: I shall start with aid dependency and then pass to my colleagues. On aid dependency, the bulk of the evidence is that countries are becoming much less dependent on aid over time. As many of your previous witnesses have noted, we have seen several countries move from low-income status to middle-income status over the past decade. The volume of aid as a percentage of domestic revenue has also been declining. For example, in Tanzania, ODA was 20% of gross national income in 1992 and 14% in 2009. That is a substantial reduction in aid in the total composition of gross national income. Ghana went from 10% in 1992 to 6% in 2009, and Bangladesh from 6% in 1992 to 1% in 2009. Overall, we are seeing countries' overall trajectory away from aid dependency. There is a question about how we target investments in the private sector. Do we crowd out the private sector? We might come to that later.

Rachel Turner: There are many things to say in response to that. I shall make maybe two points. One fundamental issue is whether the presence of aid undermines Governments' incentives to collect tax revenue. You will find in nearly all of the countries that we work in a very explicit dialogue between the donors and the Government about expectations for revenue collection. In many countries we have specific targets for that as part of our partnership principles. I think we will come on to talk about what those partnership principles feel like. You will also see a lot of support for revenue collection. Over time, our support for the tax authorities in poor countries has become more sophisticated. We have recognised that helping partner country tax authorities to focus on the large taxpayers in their countries requires quite sophisticated support, advice and policies. We are seeing some very good improvements in step-up in tax revenue. The concerns about whether aid undermines incentives to collect tax revenue are not proven if you look at the step-by-step increases in revenue as a share of GDP in the countries that we work in. There is a good story to tell there. Did you also suggest that there were concerns over the loose use of grants to the private sector in poor countries? I was not sure whether you were drawing a direct analogy.

Lord Lawson of Blaby: No, I was not making that point.

Q131 Lord Tugendhat: You mentioned Mozambique as an example of a country where aid has contributed to growth. I understand that and can well believe it. One of our biggest aid programmes, and one that Mr Anderson has had much to do with, is in India. I am a bit perplexed. The volume of our aid to India is minuscule in relation to the Indian economy. It is very hard to believe that it can contribute to growth. If the justification for it is that there are lots of poor people in India, which of course there are, there are also many poor people in Russia, the United States and many other places to which we do not give aid. The Indian

Government have the means, as they demonstrate with their nuclear programme, space programme and aid programme, to do what we are doing. What is the point of our aiding India, rather than Russia or any other place that happens to have a large pool of poor people but spends money on many advanced-country programmes?

Michael Anderson: One of the reasons that you have identified is the sheer number of poor people in India. India has more people subsisting on less than $1.25 a day and more people on less than $2 a day than all of sub-Saharan Africa combined.

Lord Tugendhat: But if the Indian Government so wished, they could make that a bigger priority than their space programme.

Michael Anderson: The Indian Government have almost the world's largest programme of welfare spending of various kinds, such as health and education. The amount that they spend on their space programme is very small. India's per capita defence spending is very small compared to all MICs and most LICs. Its per capita spending on such things as the space programme and defence is very low. We are talking about one-sixth of humanity in India. If it has one aircraft carrier, you can divide it between one-sixth of humanity.

Bill Gates made the key point about India very effectively. You need to take it on a state-by-state basis. Bihar is a state of 80 million people with a gross national income per capita of around $300 per person. It is poorer than most states in Africa by quite a long way. The central Government are very focused on trying to address poverty in India but, to be honest, it is a struggle. It is very difficult to get anything going in Bihar. It has only 10% urbanisation and appalling poverty—some of the worst in the world occurs in a place like that. Although the Government of India have a lot of resources in other states, they find it difficult to spend effectively in a place such as Bihar. Even though Bihar has a terrific chief minister and some very good programmes, the gap between where it is at the moment and where it needs to be in the future is just so very large. Much of the growth is happening in other parts of India.

DFID's assistance, as you rightly say, is a tiny proportion of its total expenditure on such things as health and education. However, our small involvement allows us to bring in technical advice, which is enormously valued by chief ministers and the Indian Government. I wish I could get the Chief Minister of Bihar to come and explain to you what a huge difference DFID makes in helping him to leverage much larger sums of money from the central Government of India. On-the-ground experience shows that we are making a very big difference in a catalytic way. The scale of need in India is just huge. For an organisation that is as dedicated to poverty reduction as DFID is, it is very difficult to ignore more than one-third of the world's poor people, who are located there.

Q132 Lord Tugendhat: I do see that. However, a number of countries—Mozambique may well be one, along with other countries in Africa—do not have the means to help themselves to overcome their disadvantages. Our aid, or that of another developed country, makes a tangible difference. I recognise that India is a very large country but I have difficulty in seeing that, at a time when we are cutting back on all kinds of programmes here and the Indian Government are advancing, we should none the less help people in India whom the Indian Government have the means to help. To take aircraft carriers, it seems odd that as we are jacking our aircraft carriers in, we give aid to a country that is building them. If the Indians want aircraft carriers, that is fine—I have no objection. If they want a big navy, that is their business, but it seems strange that we should be helping their people when their priorities lie in another direction.

Michael Anderson: We value the security component of the contribution that India makes to international peacekeeping and regional security. It is not consistent with UK security policy to want to see India's defence spending fall to zero—far from it. This is not DFID territory but within the context of the National Security Council there is quite a lot of support for India having the right kind of security profile. As for the needs of India, it has just moved to middle-income status. Most of the country is low-income. Income per capita is less than a third of China's. It is much poorer. Overall estimates of the capital investment required to bring India up to the level of China are enormous. India is sustaining very good growth at the moment. Its capacity for aid is probably far beyond what we have even started to probe because the investment needs are so high.

Q133 Lord Smith of Clifton: May I pick you up on a specific point with regard to Lord Tugendhat's question? You said that the chief minister greatly values the assistance that DFID gives him in lobbying Delhi. It strikes me as extremely bizarre that DFID is giving a provincial chief minister assistance to lobby the federal Government. Is it seemly, right or proper that we should be acting as brokers within a country in such a way?

Michael Anderson: Pardon me, I was unclear. The central Government of India transfer money to the states to spend on particular programmes. We do not help the states to lobby; that would be political interference and we would not go near it. The challenge with Bihar is that it is unable to spend all the money that Delhi sends to it. It simply does not have enough infrastructure, people, trained personnel or systems. Every year, the governor of Bihar sends money for healthcare back to Delhi because the state is unable to spend it. We are there, helping Bihar to create the systems so that it can spend its own money effectively.

Q134 Lord Forsyth of Drumlean: How much do we give to India?

Michael Anderson: The figure for last year was $280 million under the bilateral aid programme.

Lord Forsyth of Drumlean: That cannot all be spent on infrastructure to help people spend the money.

Michael Anderson: I am working from memory, so I might have this slightly wrong. Roughly 40% goes to education, mainly primary education. There is a very big problem of illiteracy and of people, especially girls, not going to school. We are driving to try to get girls into school, which has terrific knock-on effects on a whole range of things. There is also healthcare. There is a very successful programme to bring down maternal mortality in India. One of the problems is that India has some of the world's worst malnutrition. Undernutrition, especially in the key first two years of life, can lead to bad cognitive impairment, which means decades and decades of lower productivity. Therefore, we are investing in those kinds of areas as well.

Q135 Lord Forsyth of Drumlean: If the Chairman will allow me to ride a hobby-horse for a moment, I am involved with an organisation called CINI, which deals with precisely these areas and does so very well. I share Lord Tugendhat's bewilderment as to why we have to give money to the Indian Government when they are spending money on very expensive nuclear and space programmes. There are private NGOs and charities that do this work anyway. One of the problems that they have is culturally engaging people in India who have lots of money, and making some of that money available for these purposes privately. Going back to the cultural problem, are we not reinforcing a disadvantaged culture from the point of view of those people who want to see more children going to school, better nutrition and so on?

Michael Anderson: The Secretary of State has signalled that he wants to see a real change in the India programme. We are in the midst of designing that and putting it in place. I should say that our largest programmes anywhere in the world for giving funding to civil society organisations are in India. Very large sums of money go to civil society organisations in India. The new approach will emphasise much more private sector investment and partnering with business to promote small and medium-sized enterprises, especially in the poorest areas. India has very uneven growth.

Q136 Lord Forsyth of Drumlean: Does that mean that the old approach was wrong?

Michael Anderson: The Secretary of State has taken the view that we want to try a more diversified approach that recognises that India has grown substantially in recent years and that it is business that will help to pull places such as Bihar out of poverty.

Lord Forsyth of Drumlean: When officials say "the Secretary of State thinks", does it imply that the department is not committed to that view?

Michael Anderson: Of course we are committed to it.

Q137 Lord Forsyth of Drumlean: In paragraph 70 of the written evidence that you gave us in response to Question 9, you talk about the new Global Partnerships Department. Your development partnership model is not adopted by all donors. I am thinking particularly of many of the emerging donors to which you refer, whose aid programmes show a degree of self-interest. For example, some use aid contracts to secure long-term access to raw materials or other resources. Does that leave Britain at a strategic or commercial disadvantage as a result? Does your Global Partnerships Department address this link between aid and economic benefit for the donor, which some of those countries have made? I notice that China was one of the countries that you mentioned in your evidence.

Michael Anderson: I think the contracts for resources issue is mainly to do with China. We are working with a number of partners.

Lord Forsyth of Drumlean: You specifically mentioned Brazil and China.

Michael Anderson: Yes, we mentioned two. I will say something about China. We also have programmes where we work with South Africa, a young one with Turkey and programmes with a growing number of aid providers. The challenge for the entire aid world is to bring on that new contribution in a way that is helpful to the whole system.

We have had a very strong programme of collaboration with China on lesson learning in aid. Three Chinese delegations have been to visit DFID to see how we conduct aid. The Chinese position on aid has changed quite dramatically in the past year. We have seen the White Paper that the Chinese Government published in April, setting out their new approach to aid, which is considerably closer to what we would regard as good aid practice in comparison with where they were a year ago. The Chinese emphasise the altruistic aspects of their aid. That is not mere verbiage; they are sincere about it. They may approach it differently from us but much of their aid goes to places where they do not have contracts for securing resources. It is quite a complex picture. My main point is on the strategic question. How does the UK respond to the Chinese aid programme? Do we ignore it—leave it be and hope it gets better at some point—or engage actively with it and try to shape it? That is what we have been doing in recent years. The evidence is that the Chinese aid programme is evolving and that the UK is foremost in having a strong partnership with China. We recently signed an MOU with China on aid co-operation, working together and shaping, which it has not signed with any other donor. We are in quite a strong position to help shape the evolution of that programme.

Q138 Lord Forsyth of Drumlean: What about the question of whether we are at a disadvantage? If the Chinese are going around securing raw materials and we are not, does that not place us at a strategic disadvantage as a country?

Rachel Turner: UK foreign direct investment in sub-Saharan Africa still accounts for about a third of all foreign direct investment in sub-Saharan Africa. One of our approaches to the private sector, under our new private sector strategy, is very much to recognise that here in the UK and in the City we have some of the most innovative financiers, who are very interested in investing not only for return but for social impact in the poorest countries. It would be wrong to suggest that we have an unbalanced approach. We are very aware that there are opportunities to form good partnerships with the City and UK investors, as well as in what Michael has talked about in trying to work with China and Brazil on the transparency of what they are doing to invest in Africa and the behaviour that they are employing. We have a balanced approach. We can point to a number of specific interventions where we are trying to make sure that we are balanced in how we look at sources of investment. There is the work that we are doing with poor countries themselves to ensure that they have cleaner, straighter and more transparent approaches to concessioning land, for example, and concessioning infrastructure projects. We have put a lot of upfront money into the regulatory frameworks to make sure that we have clear, clean, transparent approaches to concessioning. I could tell you about many cases in more detail if we had time.

Q139 Lord Lipsey: Your evidence rightly puts great emphasis on decreasing poverty being the central goal of British aid policy. If you look at where the aid is going, you find, for example, that at one stage—without making these figures up off the top of my head—roughly 1% of our aid was going to Iraq, Afghanistan and Pakistan combined. Now that accounts for more than a quarter of our aid. Those countries obviously have something in common: they are extremely important to Britain's strategic interests, whatever their position on the relative indices of poverty may be. How do you reconcile the demand for poverty reduction in the aid programme with the inevitable emphasis on Britain's world security interests?

Richard Calvert: You are absolutely right to say that DFID's business is poverty reduction. That is what the International Development Act requires us to focus on. One of the things that we have seen in recent years is a recognition that issues around poverty reduction, stability, security and Britain's wider interests increasingly come together. Whereas perhaps 15 years ago we would not have understood that link as well and steered away from some of the more difficult conflict-affected environments, there is now much more recognition that if you are serious about reducing poverty you have to be serious about tackling conflict and instability. If you look at the countries where we have scaled up—countries where we have not had traditional programmes of assistance—such as the DRC, Sudan, Afghanistan and Iraq, they have seen a significant degree of poverty and have had a destabilising effect on the regions around them. The issue is not so much whether DFID is being drawn into a set of countries that it should not care about but that the links between poverty and wider security and national interests are much more joined up and better understood than used to be the case.

Q140 Lord Lipsey: I do not necessarily find that wholly convincing, given the scale of the change and the clear fact that, if you are giving aid in a conflict-riven society, it is much less likely to be effective in reducing poverty than if you are doing so in a country where there is reasonable peace and good governance. Would it not be better to say that aid has two objectives? One is poverty reduction and the other is the furtherance of British security and foreign policy goals. These coexist and balances are struck between them in a rough and ready way as life goes on. We may as well be straightforward about it, rather than claim that the two are always in harmony.

Michael Anderson: One of the things that has become much more evident from the academic literature in the past 15 years is the close relationship between extreme poverty and conflict. There is credible academic research to show that increasing GDP per capita from $250 to $500 roughly halves the risk of conflict in a country. In Somaliland, for example, there are drugs, criminality, terrorism, piracy and a whole range of things that are threats to global security and UK interests. However, it also has dreadful poverty. Those two tend to go hand in hand. Because of that, anyone who is serious about conflict reduction now talks about a poverty reduction component within that.

There is another problem. Paul Collier's book, *The Bottom Billion*, argues that the growing challenge of poverty is that it is increasingly concentrated in those places that are affected by conflict. As many other countries grow out of poverty, the places that are not doing so are the conflict-affected and fragile states. Increasingly, as time goes on, DFID's challenge as an organisation devoted to poverty reduction is the intellectual and policy challenge of addressing poverty in those conflict-affected places.

Richard Calvert: You are right to say that it is hard. Tackling poverty reduction in South Sudan or Afghanistan is different from tackling it in other countries. However, as we are trying to say, it is not a challenge that we can shy away from if we are serious about a global reduction in poverty.

Q141 Lord Lawson of Blaby: May I come in on this? It is an important area. Mr Anderson referred to the Prime Minister's speech today, in which he said something extraordinary: by 2015 we will be putting nearly a third of all our aid into conflict states. That seems quite extraordinary. It is largely money down the drain. It is perfectly true that conflict entrenches poverty. That is obvious and nobody would disagree with it. However, aid will not end conflict; it never has. If you can give me a case of a conflict being ended by aid, I would be very interested to know about it. Indeed, there is some evidence of the reverse. You will have read, for example, Linda Polman's book *War Games*, about how aid perpetuates conflict without intending to.

Contrary to what Lord Tugendhat said, I can see some point in giving aid to India, although he puts a strong case that the Indians ought to do more themselves. If you want aid to be effective in reaching the millennium development goals, you do not put it into conflict-affected states where the conflict will wipe out any beneficial effect that the aid could have. I am astonished by that. I have other questions, but perhaps you would respond to that.

Michael Anderson: Many of the terrific success stories in growth and poverty reduction are in countries that are just coming out of conflicts.

Lord Lawson of Blaby: But they have not come out of conflict because of aid.

Michael Anderson: No, aid never works by itself. Everyone accepts that the development, diplomacy and security guarantee components go together. There is broad consensus that you need all three in a co-ordinated way. It is part of the UK's comprehensive approach to bring all three together. From talking to military colleagues, their view is that you cannot end conflicts by military force alone. You also need the reconstruction and the assistance for health, education and reforming basic services. A good argument for using aid in conflict-affected areas comes from talking to such people.

Q142 Lord Lawson of Blaby: Let us take a recent concrete example. In Sri Lanka, there was a terrible conflict between the Government and the Tamil Tigers, which has, happily, come to an end. However, that had nothing whatever to do with aid. I cannot see how you think that this money you are giving can possibly have any beneficial effect in reducing conflict.

Michael Anderson: I have two points to make. First, it has a beneficial effect in reducing poverty. We have lots of good stories about how aid is highly effective in conflict-affected areas, partly because we are starting from such a low base. It is quite easy to have a good effect. I can say more about that.

On conflict being reduced in part by aid, I refer you to the work that Robert Rotberg has done at Harvard on how to make peace settlements stick. He looked at a range of peace settlements around the world, asking which ones had stuck and which ones had come unglued. His view is that the ones that stick always have a component of sufficient resource to make sure that people get some dividend from it. Aid, in his view, plays an absolutely critical role in making these diplomatic peace agreements stick.

Richard Calvert: To add one point of clarification, the 30% figure that you picked up from the Prime Minister's speech refers to aid to fragile countries, rather than countries that are necessarily in a state of conflict.

Lord Lawson of Blaby: I was quoting his own words.

Richard Calvert: The commitment that around one-third of the programme should go to such countries refers to countries that are emerging from conflict as well as those that are in a state of active conflict.

Lord Lawson of Blaby: This is something that we need to get more evidence on.

Q143 Lord Smith of Clifton: Clearly, in the engine of development, providing for the private sector and prosperity for more people is a shift in emphasis. Do you have the personnel and resources to give such advice, bearing in mind that your previous model was focused on improving the public sector? In previous sessions we heard evidence that, while funding for the aid programme will increase, staffing in DFID will be reduced. How will you tackle the problem of reduced staff and a change in emphasis in terms of your expertise?

Richard Calvert: Perhaps I can deal with the final point about staffing levels and administration costs and then Rachel can say something specifically on the private sector. I am glad that the point has come up; I saw it in the previous evidence sessions and it is important to say where DFID is on staffing levels. It is absolutely right to say that our core administration cost budget is reducing by one-third over the period of the spending review, as is the case for other government departments. We are making reductions in a number of our administration costs and central corporate costs to deal with that. At the same time, the spending settlement also allows us to scale up our front-line staffing and so to increase our provision for staff who are directly managing programmes in countries. In particular, we can bring in the kind of professional skills that we clearly need if we are to manage a growing programme in a way that delivers results and value. We have a more complex picture than a number of government departments in admin costs. That means that the department is being reshaped so that we have a smaller corporate centre and spend less on a number of our nuts-and-bolts admin costs but increase our staffing on the front line. The overall picture for departmental staffing is that numbers will probably stay at around 2,400 over the period. Within that, a significantly higher proportion of staff will be working on the front line and a smaller proportion on corporate tasks.

Q144 Lord Smith of Clifton: Before your colleague continues, could she also comment on whether there is a pool of talent out there that is available for you to recruit from to assist this private sector stimulation?

Rachel Turner: I shall make three points about bringing in private expertise. We are not starting from absolute zero. We have had a portfolio of innovative work with the private sector in the past. We also have a set of people with the appropriate skills. Nevertheless, we are also very ambitious about where we want to go in the future. The other contextual point is that when we talk to business and the private sector about the nature of the partnership that they want with us, and which skills they most want in such a partnership, they do not always want to replicate their own skills. Quite often they want to access our development understanding, our understanding of political or macroeconomic risks, or our ability to work on the regulatory and public sector side.

Nevertheless, having raised both those points, we want to bring more private sector DNA, as we say, into DFID. We want to do that for two reasons. We want to be able to work more effectively to create the right environment for private sector investment. We also want to bring the private sector in to help us think about how we can deliver our own aid better. Sometimes private sector approaches to public sector delivery can be very helpful in the context of aid. I am thinking about such things as approaches to logistics, reaching the remotest parts of rural communities, taking risks, nurturing talent and so on. We are ambitious to bring in private sector skills.

In relation to new recruitment, which Richard just spoke about, we are ambitious to bring in people from the private sector, and it is working. There are people who are very excited by this challenge and want to bring their expertise, whether it is from the City, manufacturing or supply chain management. They want to come and work for us. We are optimistic but we are not there yet. We are recruiting, so it is a case of watch this space on this.

Q145 Lord Smith of Clifton: Could you give us some examples, please? "Private sector" is a generic term. What sort of skills are you looking for, and in what sort of industries or sectors within the private sector?

Rachel Turner: I would say probably three things in relation to that. First, we need financial sector skills, particularly understanding investment structuring and the structuring of infrastructure investment. We have a very large and growing portfolio to invest in trying to catalyse private sector investment in infrastructure. We need people who understand how to structure debt and equity. We particularly want people who can help us to think very carefully about how we use our subsidy in relation to the private sector. We do not want the public sector money that we put into this process to be gobbled up unnecessarily. We absolutely want the maximum value from it. There is a set of particular skills from the financial sector.

Secondly, there are skills from the retail side to do with supply chains and thinking imaginatively about how to extend them to poor people in poor countries. We have some good ideas about that. We have a good and growing portfolio but we want to extend that work. There is a lot of experience in the UK and internationally that can help us to be more imaginative in that regard.

Finally, there is a set of skills in what the jargon calls fast-moving consumer goods. The kind of challenges that we face are about thinking of ways to get the goods and products that poor people can afford and want out to the remotest areas. We want to work with people who might have done that in the pharmaceutical industry or the retail industry. There are some very imaginative ideas that we want to bring in and harness for our programmes.

Q146 Lord Tugendhat: In your written evidence, you refer to a decisive shift towards a model of development partnership in which aid can be, in effect, unconditional as long as the recipient upholds a set of core principles on poverty reduction, human rights, other international obligations and accountability, and maintains a sound public financial management system. That requires some quite difficult assessment processes. Could you tell us a little about how you conduct that assessment?

Rachel Turner: There is a lot to say about this. I will start but you might need to interrupt me.

The Chairman: You might like to summarise it and send us a supplementary paper.

Rachel Turner: We will send you more details. We have these four partnership principles. The first three are poverty reduction and reaching the MDGs, human rights and improving public financial management. The fourth is a new one that we have added recently, and which the Secretary of State is particularly concerned about—strengthening domestic accountability. Those are the four partnership principles.

In assessing those, we look at recent past and expected future commitment to these principles separately. We unpack each of those and look specifically at a Government's commitment to them. We do not just make best guesses about future intent. We back that up with what evidence we have seen from recent practice. We then benchmark them, so we try to set out specifically what good progress looks like in relation to each of them.

For example, in poverty reduction, we focus mainly on whether budgets are sufficiently pro-poor and whether countries' budgets target the poorest. We also look more widely at other policies that are important for poverty. For example, we might look at policies around the extractive industry. That is an example that I found in our partnership principles for Mozambique. We have looked at transparency in the extractive industries.

We look for specific progress on human rights. We use a range of external reports to help us do that, such as those published by Freedom House. For example, we might specifically benchmark progress in prison overcrowding or access to justice. Public financial management is obviously extraordinarily important for us. We focus on a range of issues to do with how well a Government stewards its finances. We tend to focus particularly on the quality and capability of the supreme audit body, the quality of procurement and payroll processes, for example.

Accountability is newer for us. It is the new partnership principle that has been added. We look in particular at the issues of citizens' access to information, the processes of scrutiny and how well parliamentary committees work in the countries with which we are involved. We use a range of measures to do that, including the Freedom House index and the global integrity index. We have all these processes that allow us to assess progress.

Q147 Lord Tugendhat: That is a very impressive list. I guess that it has not been going for so very long, but you will from time to time come across countries that are falling down on some of these tests. What is the procedure in the department whereby you would decide that country X is not cutting the mustard on a sufficient number of these and that you should suspend, withhold or at any rate not dish out in the normal way your aid? Would it be the Secretary of State who decides? How would it be done?

Rachel Turner: It would be the Secretary of State. We tend to articulate this as a four-step process if we are concerned about performance on one of these partnership principles. The four steps are fairly straightforward. The first is that we signal concerns to the Government and we intensify dialogue around them. We might delay all or part of a disbursement. In our annual report each year, we publish any specific delays to disbursement because of concerns about a partnership principle. We may change the way in which we deliver aid. We may take aid away from the Government and route it through NGOs or other sorts of partnerships. Finally, we may stop aid to the Government and/or to the country. So we have that four-step process.

Q148 Lord Tugendhat: What you say is very interesting but I have one final question on it. If you are deeply unhappy about a particular country and you decide that it is necessary to take the actions that you describe, to what extent would you collude with the European Commission or other aid-giving countries that were close to you? Would these be unilateral decisions or would you seek to take those decisions in conjunction with other aid providers?

Rachel Turner: The first point of principle is that they are unilateral to the extent that they are our decision. They remain a decision for our Secretary of State and we would not be bound by a decision taken somewhere else. On the other hand, in many countries we have agreements between a group of donors, where we have collectively expressed these partnership principles and the benchmarks around them, particularly in some of the countries where we have been giving aid for government services. In those cases, the donors would normally sit down together and have the same set of benchmarks for partnership principles, and they would agree together if those had been breached. They would reach a collective decision on breach and would then take their individual political decisions on how to react to them.

Michael Anderson: I should add that we do of course consult the Foreign Office during this process and draw in advice from other parts of the UK Government to ensure that we are testing our understanding against theirs.

Q149 The Chairman: May I just follow this up? You are also committed to expanding the support to fragile states. As your evidence shows, 20 of the 27 priority countries are classified as fragile states. In developing the development partnerships, is there not a conflict here? Is there not a real difficulty, because so many of the fragile states simply do not have the structures, the accountability and so on that enable the development partnership to work? How do you resolve that?

Rachel Turner: Fundamentally we resolve it through setting ambitions that are context-specific. We set the ambitions for our partnership principles in relation to the context in which we are working.

Michael Anderson: Partnerships are inevitably difficult and different. If the whole point of a partnership with a Government is in a context where a Government does not exist, is extraordinarily weak or does not have full control over its territory, we recognise that we need to adjust our modalities of partnership.

Q150 The Chairman: That means that there is a conflict.

Michael Anderson: It means that we adjust the way in which we approach partnerships.

The Chairman: You drop the partnership elements of the development partnership.

Michael Anderson: No. The principles that are articulated—the four components that Rachel set out—apply most strongly to general budget support. As for other modalities of using aid, we use sliding scales, depending on what is appropriate. In Somaliland, for example, we are working heavily through NGOs to provide assistance. Malawi is a recent case where we have decided to suspend general budget support—the Minister of State made a statement today on that matter—but we are using other channels for delivering assistance. With fragile states, it is often difficult to partner directly with the Government. Sometimes we can, but frequently we cannot. I will give two examples. In Afghanistan, we do not put the money directly into the coffers of government, because we reckon that the risks are too great, so the bulk of the money goes to the Afghanistan Reconstruction Trust Fund, which has separate financial plumbing to deliver the aid. Similarly, with aid to the Palestinian Territories we have frequently operated in ways that go round the Palestinian Authority—operating through a series of banks and making payments directly to civil servants, teachers, nurses and so on. The way in which we channel aid varies. We frequently find that in fragile states we have to partner with NGOs, with sub-national entities and sometimes with particular ministries. The overall approach is to ask, "Is there good financial management? Is the entity that you are partnering with respecting human rights? Are we seeing accountability?" These basic principles apply in this range of partnerships.

Q151 Lord Forsyth of Drumlean: May I just ask about the evaluation of suitability for this Government-to-Government aid? What kind of percentage of the amount that is awarded is spent in the due diligence and evaluation to get to the stage at which a cheque is sent to the Government?

Michael Anderson: I do not think that we have ready figures on that.

Richard Calvert: I am not sure that I could put it in those terms but, clearly, if we were considering providing budget support to a country, we would go through a long and detailed process of analysis before we did so. This is not a one-week exercise.

Lord Forsyth of Drumlean: That is why I am asking the question. The thought in my mind is that, if you are going through such an extensive, difficult and complicated process using very expensive, very able and committed people, that must absorb quite a large part of the money that is eventually sent. I am intrigued that you do not know the figure, because although of course you want to get value for money, if you are spending a disproportionate amount on a kind of due diligence process, that would defeat the object of the programme.

Richard Calvert: Let me give a sense of this. This would be core work for a lot of country office staff. If you are in the DFID country office in Malawi or—

Lord Forsyth of Drumlean: But that is still a cost, isn't it? If they are sitting there doing this, they are not doing something else.

Richard Calvert: It is a cost, but if we are in a country where we are providing budget support that is a key use of their time. The proportion of our costs that goes on administration is a little over 2% at the moment and coming down to 2%. You get some sense of the scale of programme spend we have compared to the costs of administering it.

Q152 Lord Forsyth of Drumlean: Just 2%? I find it very difficult to believe that you could do all that for that amount. If you applied these criteria to our own country, the costs and the difficulties in making an assessment—

Richard Calvert: One of the other things to say is that we do not always have to do the work from scratch. The donor community will often be doing analysis, the World Bank may be doing detailed analysis and donors collectively will be doing detailed analysis. We are not all sitting doing our own analysis in a vacuum. There may be examples where we are taking the lead on something, while in other cases we may be drawing on analysis that other people have used and developed.

Lord Forsyth of Drumlean: Could you let us have a note on what you think the relative balance of cost to programmes would be in particular examples?

Richard Calvert: Of course.

Q153 The Chairman: Can I go back to Mr Anderson's reply to my last question? I fully understand all the difficulties but if, in some of these fragile states, you are concentrating on NGOs or bodies other than the Government to deliver the programmes, there must often be a very high risk that they cannot deliver the accountability and so on. How do you assess that and make judgments? To what extent do you just find sheer losses and money wasted?

Michael Anderson: I shall say a brief word and then pass on to Richard. On balance, our programmes in fragile states are much more risky. There is no question about that. Sometimes there are difficulties in monitoring and sometimes there are difficulties in capacity locally. There are a range of challenges in fragile states, especially where there is insecurity, which do not apply elsewhere. That said, in some of our fragile states, because we frequently control very directly the way in which money is spent, we arguably sometimes have much better information about exactly where the money is going. Our staff costs go up, of course, because we put more staff time into monitoring in fragile states. Because we sometimes take more direct control over the disbursement and monitoring, we have a better grip of what is going on in some of those contexts. Richard, do you want to talk about the point about losses?

Richard Calvert: Michael is right: the context defines quite significantly how we work in a country. In a country where we have more confidence in the Government and the overall environment in which we are working, we may well work in a more hands-off way. In a country that is much more difficult, we would be much more hands on. That has an impact on the extent to which we are tracking day by day the detail of what money is being spent. If you step back from that and say, "Do we achieve what we want to achieve in fragile states compared to others?" again, the way in which we define success and set outputs and outcomes for projects may vary in those countries. If we are providing budget support, we may well be looking much more at the overall contribution to outcomes in the education sector, where our contribution is assessed alongside the contribution of the Government's own resources and other contributors to that sector. If we are working in a much more difficult environment, through an NGO, for example, we would set our level of outcomes and results much more around specific outputs in a particular area. It is not easy to say that we are more successful in one or the other, but success may be defined in different ways.

Q154 The Chairman: Can you give us an example, or the number or scale of cases, where a programme is stopped for a variety of these reasons?

Richard Calvert: To give one example, in the six months after the election last year we stopped around £100 million-worth of programmes, which were assessed on our project scoring system as essentially the weakest-performing projects. All our projects are scored each year in terms of the extent to which they are achieving their outcomes and purpose. Clearly, some are exceeding, some are meeting and some are falling short. We cut off the ones at the bottom. Part of our much stronger focus on results and rigour round the investment case is to ensure that, as we manage the scale-up of projects over the period ahead, we continue to be rigorous in assessing what projects are achieving and, where they are not achieving, in being prepared to say that we will stop and put our money elsewhere.

The Chairman: If possible, could you give us a note on examples of where you have stopped?

Richard Calvert: We certainly can.

Q155 Lord Smith of Clifton: Let me take up a point raised by Lord Forsyth. You say that in difficult areas the projects are much more risky. Presumably, if you scale down to outsourcing to NGOs and others, the amount of monitoring you are doing is proportionately greater, so the cost of monitoring, due diligence, sweeping up afterwards, stopping or whatever must be a higher proportion than in areas where there are not these problems.

Richard Calvert: That is correct. There is often a higher level of administration costs to managing programmes in difficult environments. That is absolutely fair comment.

Q156 Lord Lawson of Blaby: I will make two short points and then one slightly more substantial one, if I may. Mr Anderson referred to the Prime Minister's speech today. One of the things he said was that we have to use aid differently. He gave one or two examples of that, one of which was "training the next generation of business leaders, mathematicians and scientists". There are two ways in which you can do that. You can train them here by having them at British universities or other institutions of higher education, or you can train them in their own country. How do you decide between the two? You may think that it would be better done in this country, as tends to be the French view—the French like to train the future elite of francophone Africa in French universities and institutions, because they think that, in addition to the very good training that the cadre of future leaders from these countries may get there, it might make them well disposed to France. The same thing might apply here—it might make them well disposed to this country. How do you decide between the two? Can I take it that DFID, with its bloated and ever increasing budget, would not expect the Department for Education, which is having to face cuts, to finance that in this country?

Michael Anderson: At the moment, our expenditure on higher education is roughly 9% of the total expenditure on education.

Q157 Lord Lawson of Blaby: Does that include training? The Prime Minister was talking about training the next generation of business leaders, mathematicians and scientists, so that is all encapsulated in that, is it?

Michael Anderson: There are of course separate training programmes specific to a number of projects, depending on skills needed, government desires and so on. I would treat post-qualification training separately. Undergraduate and postgraduate provision of education accounts for about 9% of our total education expenditure, as I said. Some of that operates through scholarships such as the Commonwealth scholarship, some of which are tenable here, so there are some programmes of people coming to the UK for training in specific purposes. The Foreign Office has quite a large programme of scholarships, such as the Chevening scholarships, which are funded by overseas development assistance and are all tenable here, with a bit more of the motive of getting people familiar with and well disposed to the UK, while improving their skills. Some of our programmes in higher education involve partnering between British universities and universities in Africa, Asia and elsewhere—the so-called DelPHE programme, which we support, supports this twinning. It is partly about bringing some academics here to the UK to bring stronger links but it is also about taking people from the UK to those universities and supporting them. Quite a lot of our programmes are also about strengthening universities in these countries to create their own capacity. That frequently involves strong links with UK universities.

Q158 Lord Lawson of Blaby: I shall ask about just one fact. If you do not have it in your capacious head now, I am sure you could let us have a note. How much of the money that is provided to finance the education of future leaders of developing counties in British universities and other tertiary institutions comes out of the DFID budget?

Michael Anderson: I do not have that figure. I shall have to consult BIS and other departments.

Richard Calvert: If I may say so, this is partly about what comes out of the overall government aid budget. Part of the aid budget is managed by the Foreign Office. In particular, one of the key scholarship programmes comes from that part of the aid budget that is managed by the Foreign Office.

Q159 Lord Lawson of Blaby: I am talking about the DFID budget. How much of the total comes from DFID's pot? There is one other quick point. You may know this off the top of your head but, if not, could you let us have a note? I think Mr Calvert said that one of the objectives of British overseas aid was to help these countries combat climate change. How much of the UK aid budget is devoted to this?

Richard Calvert: I think it was my colleague who referred to that.

Lord Lawson of Blaby: It was. I apologise.

Michael Anderson: The International Climate Fund is £2.9 billion over four years. It is split between DFID, the Department of Energy and Climate Change and Defra, but the total amount is all ODA. It all counts towards the UK ODA component. It has three main targets. One is to preserve forests and prevent deforestation, which has a range of benefits for poverty reduction and biodiversity. The second is to promote low-carbon energy, including access to energy, in low-income countries. The last is to promote adaptation to climate change, including extreme weather events.

Lord Lawson of Blaby: The second one involves how much money?

Michael Anderson: We can send you a note on that.

Q160 Lord Lawson of Blaby: That would be very kind. The more substantial question, with which you are very familiar, is to do with the 0.7% of GDP target, which seems very odd for reasons that one of my colleagues has already mentioned. This is an input rather than an output concept. It is all the odder when there is apparently an intention to make it a statutorily binding figure. I do not think any other country has done this. That is the intention, is it not? What on earth is the justification for doing this? It is a figure that was simply plucked from the air many years ago by the Brundtland Commission, which did not

Richard Calvert: It is clearly right to say that the 0.7% target has a long history. It goes back 40 years or so. One of the reasons why the target has remained relevant, and has in many ways gained in relevance, is that it has been reassessed and reviewed consistently over that period, particularly over the past 10 years or so. In that time, the focus has moved increasingly from talking about poverty alleviation as something that we would continue to do into the future to a much more specific set of targets and halving world poverty by 2015. The 0.7% target and the volume of resources needed to meet the MDGs have been reassessed around that.

Clearly the 0.7% target has political significance. It would be impossible to say that it is purely a target derived from a mathematical calculation of the aid level required. Nevertheless, the continuing importance and validity of the target shows that it still broadly reflects an assessment of the resource requirements needed to meet the MDGs. The proposal to embed it in legislation is intended to end any doubts about the Government's commitment to deliver that target. The spending review that was announced last year has set a budget for the Government. DFID accounts for the majority of that budget, which will deliver 0.7% from 2013 onwards. The purpose of the legislation is to say that this is not just about reaching 0.7% in 2013; it is about ensuring that there is confidence that the UK will continue to meet that target into the future.

Q161 Lord Lawson of Blaby: Why has no other country done that or proposed to do it?

Michael Anderson: Other countries have legislated, most recently Belgium.

Lord Lawson of Blaby: I am talking about major countries.

Michael Anderson: I think five European countries have legislated on this. I shall have to double-check but we are by no means alone. I should add that there is an academic debate about whether 0.7% is the right level. Professor Sachs, among others, has been in the forefront of saying that if we were to revise the figure, it would be revised upwards in light of the higher ambitions of the MDGs. It is subject to constant academic argument. The centre of gravity is staying at 0.7% because it has a long political history.

Q162 Lord Lawson of Blaby: You will get people on all sides of the debate, of course; you always do, in every debate. How is this consistent with what has been clearly stated by the Secretary of State and many other people on a number of occasions—that the objective of aid is to make aid redundant and eliminate it?

Michael Anderson: It is absolutely the case that, over time, on the poverty reduction component, the aim is to make aid redundant. Unfortunately, we are nowhere near that in the medium-term future.

The Chairman: We must move on. We have two more sets of questions. This is a very important session so I am happy to let it run on but we shall have to finish fairly soon.

Q163 Lord Forsyth of Drumlean: In paragraphs 60 and 62 of your evidence, you imply that with good macroeconomic management developing countries can efficiently absorb significantly higher levels of aid. We touched on this earlier. This appears to discount a large body of evidence which suggests that constraints to scaling up are to do with politics and governance and not with macroeconomic notions of absorption. Can we take it that you think these concerns have been overplayed?

Michael Anderson: I do not think that the concerns about politics and governance have been overplayed. There is a very strong relationship between effective governance and development. Admittedly, the flow of causation is not entirely clear but the correlation is strong. It is widely accepted that effective political governance is absolutely critical to economic growth, including improved investment and productivity.

Linked to that is something about the legitimacy of the state. For example, an African state that is accepted as politically legitimate by its citizens, by some international measures, is estimated to have an annual growth rate that is more than 2% higher—in annual per capita GDP—than one whose legitimacy does not command popular support. That is a binary comparison. Corruption clearly thrives in an environment of bad governance, making it impossible to control some of the criminality and so on. Therefore, governance is absolutely essential to creating the conditions for growth.

DFID's governance portfolio is very large. It includes programmes on improving taxation, very substantial anti-corruption programmes, including our pioneering work with the Met to track down proceeds of fraud and bribery. We do a lot of work on empowerment, accountability, security and justice, parliamentary elections and rights. It is fair to say that DFID is seen as a leader in the donor community for working on governance. We take governance very seriously and invest heavily in it. The Secretary of State has said that he regards many of our governance programmes as offering some of the very best value for money that he has seen in the DFID portfolio because of the kind of changes that they can bring about. We recognise that in donor-dependent countries the political dynamics that donors can introduce, especially if they affect accountability, can be problematic. I think you took evidence on this from Adrian Wood. That is why DFID is very clear. It abides by the principles of the Paris declaration, especially on the Government's ownership of the development priorities. We have already discussed our principles of partnership and why we use either general or sector budget support quite a lot as a way of enhancing accountability. Far from disregarding these elements, we think that they are absolutely critical and spend a lot of time developing them.

Q164 Lord Lipsey: On corruption, we heard some striking evidence from Sir Edward Clay about his famous initiative in Kenya. It was not quite clear how of that much was due to him and how much was a considered strategy on the part of the British Government. How good do you think you are at detecting where aid is being distorted for reasons of corruption? When you do detect it, what kind of tools do you have at your disposal to minimise that effect?

Michael Anderson: The Secretary of State plans to write to you about that piece of evidence. That letter regarding Sir Edward Clay will be with you soon.

Richard Calvert: Fraud and corruption are incredibly important issues for us within the programme. We take them extremely seriously. There is a set of things that we do to understand the risks of fraud and corruption. I shall give a brief overview and you can come back to me if there are things that you want me to go into in more detail. There is one set of interventions that we use to assess fraud risk. On that basis, we design the kind of interventions that we think will minimise any risk of fraud.

Lord Lipsey: What sort of interventions?

Richard Calvert: That would be what we call a fiduciary risk assessment. For example, if we were thinking of putting funding through a government budget, we would undertake a set of analyses, looking at the strength of the institutions, the transparency of the budget and the quality of scrutiny. Then there are the things that we would do in light of that to determine what kind of monitoring mechanisms we needed as money was being spent. Then there is also a set of actions that we would take if there were allegations of fraud or corruption in relation to any of our programmes. We would immediately investigate. Fraud is proved in between 30% and 35% of the allegations that we receive; we establish that there is evidence of fraud or corruption. In those cases, we of course seek full compensation or return of any funds that have been lost. Our record on recovery in cases of fraud is something like 70% to 75% over the past five years or so.

Q165 Lord Lawson of Blaby: For clarification, when you say that the Secretary of State will send us a note on the evidence from Sir Edward Clay, do you mean his original evidence about corruption in Kenya or his subsequent written evidence on the appalling story of the British couple who were working on farming and development in Tanzania?

Michael Anderson: I had better not speak on behalf of the Secretary of State. I know that he is planning to send a letter.

Lord Lawson of Blaby: There are two different bits of evidence, equally disquieting. I wondered which he was going to write to us about. Perhaps he will write about both, in which case we would be very happy to receive his letter. DFID did nothing at all, according to Sir Edward.

Q166 Lord Lipsey: Following the thrust of the questions that I was pursuing, I can see what you are trying to do. There must be some very tricky judgments at the margin, where you are sure that a piece of aid policy has been extremely effective against poverty but you know that the head of a village somewhere has been creaming off 5% into their own pocket. Therefore you have a dilemma. If you stop his 5%, you also stop the huge benefits to the town or village where that aid is going. Is this just something where you have to use human judgment? Do you have a set of rules? Do you have a "one fraud and you're out" rule?

Richard Calvert: We are absolutely clear that we have zero tolerance for fraud. To imply that a level of fraud is acceptable within the funds that we are managing is not a position that we take at all. Even if a programme is delivering development benefits—as was the case with education funding in Kenya, for example—but we detect fraud within that programme, we will stop our funding and try to put it right. It does not mean that we will not try to go back into the sector once we feel that we have dealt with the issues. However, we absolutely are not in a position where we say that there is an acceptable level of fraud. Our policy on fraud is clearly one of zero tolerance.

Q167 The Chairman: Did you say that around 35% of cases where fraud is suspected prove to be fraud?

Richard Calvert: It is something like that. We have a counterfraud unit, which will investigate any allegation of fraud from any source. It establishes that there is no case to answer in the majority of allegations. Many things can motivate allegations of fraud. We are concerned with the ones that have legs.

Q168 The Chairman: Can you give us any idea of the total proportion—it must be very small—of the aid programmes that result in fraud that has to be repaid? Obviously it is only a proportion of the ones where you suspect fraud.

Richard Calvert: You are right—it is a small proportion. In the past four or five years, we have had gross losses of £4 million to £5 million, of which we have recovered around 70%. There is an upward trend in those numbers. We have become both more systematic about putting in place mechanisms for fraud to be reported and extremely rigorous about following up all allegations. We see the numbers tending upwards—both gross losses and recoveries. That gives you an idea of the scale of reported and detected fraud.

The Chairman: We will look forward to getting the Secretary of State's letter. I suspect that this is an issue that we will wish to investigate with him when he comes before us towards the end of the inquiry. If there are no other questions, I thank our witnesses very much for what has been a long session and for the evidence that they gave us previously. It has been very helpful, so thank you very much.

Department for International Development—Supplementary written evidence

Supplementary memorandum by DFID following the evidence session with officials on 19th July 2011

Q1. What is the cost of carrying out due diligence checks and assessments of partners against DFID's partnership principles relative to programme costs?

1. As explained during the DFID officials' oral evidence session, the UK's relationship with any aid recipient country is underpinned by four shared commitments – the commitment to poverty reduction and the Millennium Development Goals, respecting human rights and other international obligations, strengthening public financial management and strengthening domestic accountability.

2. To assess our partner countries' acceptance of these commitments we use a variety of tools such as Governance Analyses and Fiduciary Risk Assessments. We also monitor progress during the course of the aid relationship through annual performance reviews, joint donor to government fora and regular bilateral discussions with partner governments. Our assessments also draw on the knowledge and experience of other bilateral donors as well as the World Bank and IMF.

3. The efforts made to assess partnership commitments are integral to the core work of a country office and form part of DFID's standard business planning and project cycle management procedures. It is therefore difficult to separate these costs from the rest of programme spend.

4. However, some indication of the relative balance is given by looking at the balance of total operating costs (Administration and Front line delivery costs) to overall programme costs. This varies across the country programmes and between countries which use differing aid modalities.

5. The ratio of total operating costs to programme costs in three countries in receipt of direct government to government assistance in 2010/11 is 1.8% for Tanzania, 2.2% for Ghana and 2.6% for Rwanda. This can be compared to our programmes in fragile states where direct government to government assistance is not used as the primary aid modality. The ratios for our programmes in DRC, Nepal and Nigeria are 3.5%, 4.1% and 4.3% respectively.

6. The above ratios are broadly consistent with the findings of the National Audit Office review of budget support[232] which reported that the country administration costs as a percentage of total country programme cost for those countries in receipt of budget support was at least one percentage point below that for those not receiving budget support.

232 National Audit Office publication February 2008 "Providing Budget Support to Developing Countries", http://www.nao.org.uk/publications/0708/providing_budget_support_to_de.aspx

Q2. Can you give us an example, or the number or scale of cases, where a programme is stopped for a variety of reasons?

7. Within the first six months after the election last year, the Secretary of State took action to terminate a number of projects. A total of £100m was reallocated from projects which were not performing to activities that were deemed to have greater potential for reducing poverty and accelerating progress towards achieving the MDGs. The table below gives five examples of such projects that were either closed or had funding reduced.

Table 1. Planned closure or funding reduction of DFID projects in financial year 2010/11

	Department	Project Title	Funds Available for Reallocation	Reason For Closure
1	Conflict Humanitarian and Security	European Centre for Conflict Prevention	£120,000	Poor value for money and lack of sufficient impact.
2	DFID Ethiopia	Water, Sanitation & Hygiene Project	£3,000,000	This project is currently not disbursing on schedule due to capacity bottlenecks at district level. Funds reallocated to alternative service providers.
3	DFID Ethiopia	HIV/AIDS Governance Pooled Fund	£1,000,000	The high volume of resources from other donors in Ethiopia provides more than adequate coverage for HIV/AIDs. Greater value for money could be achieved from our resources by reallocating to other health priorities.
4	DFID Pakistan	Punjab Devolved Social Services Programme TA	£7,000,000	Disbursement arrangements have not provided good value for money. The saving of some £7m will be re-allocated to other more efficient DFID support for basic service delivery in the Punjab.
5	Middle East and North Africa Department - Yemen	Maternal and Newborn Healthcare Project	£1,612,065	This project has been underperforming and there is no prospect of significant improvement in the short/medium term. Resources reinvested in other priority work in Yemen.

8. The Secretary of State also took the decision to terminate a number of UK-based development awareness projects funded by DFID. The objective of these projects, which involved schools, early years educators and youth performance groups, was to promote awareness in the UK about development issues and help young people become "global" citizens. The projects were discontinued as part of the Coalition Government's commitment to ensure that the DFID budget is disbursed in the countries where it will do the most good and where taxpayers will clearly see value for money.

9. In addition to these closures as a result of poor performance or poor value for money, DFID can suspend, interrupt, delay or change how it delivers its aid if the partner country is assessed as having breached one or more of its four partnership commitments.[233] Changes to programmes as a result of these breaches are reported in the DFID Annual Report[234]. The relevant table from the Annual Report is given below.

Table 2. Changes to programmes during 2010/11 as a result of breach of commitments

Country	Programme	Issue	Consequence
Malawi	Health SWAP	Concerns about value for money of some health procurements (initially raised by the Procurement Oversight Agent that DFID contracts on behalf of all pool partners). Forensic Audit conducted.	£598,697 funds withheld.
Uganda	Uganda: Joint Budget Support Operation	Inaction on 2008 audit report of corruption allegations during the 2007 Commonwealth Heads of Government Meeting, which led to a withholding of £2.5m of PRBS in FY 2009/10.	Inadequate action led to a further £5m of PRBS being withheld in FY 2010/11. Decision taken in June 2011 not to reinstate the £7.5m but to reallocate to off budget expenditure.
Uganda	Uganda: Joint Budget Support Operation	Underperformance against performance targets	Disbursement was reduced by £2.8m
Ghana	General Budget Support 2010-2011	Inability to meet 17 out of the 42 PAF Targets and 4 out of 15 PAF Triggers	Reduction of initial performance disbursement amount by 5.33% (from £38 million to £36 million)
Afghanistan	Afghanistan Reconstruction Trust Fund	There is no IMF programme in the country at the moment. Concerns about financial management and accountability.	Delayed £85 million payment that was due in November 2010

Q3. How much of the money that is provided to finance the education of future leaders of developing counties in British universities and other tertiary institutions comes out of the DfID budget?

[233] The four commitments are towards - poverty reduction and achieving MDGs, respecting human rights, strengthening public financial management and strengthening domestic accountability.
[234] Table 8, page 96, Department for International Development, Annual Report and Accounts 2010-11: Volume I. http://www.dfid.gov.uk/Documents/publications1/departmental-report/2011/Annual-report-2011-vol1.pdf

10. The British Government provides funding to two schemes which enable people from developing countries to study with British Universities and other tertiary institutions – the Commonwealth Scholarships and Fellowships Scheme (CSFS) and the Chevening Scholarships programme.

Commonwealth Scholarships and Fellowships Scheme

11. The CSFS is a pan-Commonwealth scheme established in 1959, under which member governments offer scholarships and fellowships to citizens of other Commonwealth countries. A total of 700-800 awards are made by CSC each year. The UK contribution to the scheme is managed by the Commonwealth Scholarship Commission (CSC).

12. The Department for International Development (DFID), the Department for Business Innovation and Skills (BIS), the Foreign and Commonwealth Office (FCO) and the Scottish Government all provide financial support to the CSC.

13. However, only DFID's support is targeted towards candidates from the Commonwealth's developing countries, and therefore counted as Official Development Assistance (ODA) – the other Departments provide support for scholars from the Commonwealth's richer nations.

14. Total British Government spending on the CSFS was £18.6m in 2010/11 of which DFID funding was £17.5m[235]. On average, approximately 92 percent of the funding for CSFS for the three years from 2008/9 to 2010/11 was from DFID with the rest coming from FCO, BIS and the Scottish Government. Levels of CSFS funding for 2011/12 and subsequent years are being reviewed, and will be confirmed in the near future.

Chevening Scholarships

15. The Chevening scholarships programme is the other major tertiary education funding provided by the British Government to students from developing countries. This programme is managed and funded by FCO, with some partnership funding from third parties.

16. The FCO plans to award over 650 Chevening scholarships in 2011/12, mostly for one-year masters degrees, to scholars from over 100 different countries. Many of these are developing countries, and a high proportion of Chevening funding is therefore counted toward Official Development Assistance (ODA).

17. FCO spending on Chevening scholarships in 2010/11 was £14.2 million, of which £12.4 million counted toward ODA.

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[235] Approximately 90 percent of this funding is spent on awards and programme costs with the remainder spent on administrative costs. The Commission strategy seeks to ensure that administrative costs remain below 10% of total programme expenditure. A 2010 DFID review noted that this compared favourably with the UNESCO scholarships programme, and schemes for higher education scholarships in France and Germany. It also noted the significant additional financial resources that the programme has leveraged.

18. FCO spending on Chevening scholarships in 2011/12 will be £15.9 million, of which around £14.6m is expected to count toward ODA. This figure is subject to variation as scholar numbers and costs are still being finalised. Funding levels for Chevening for 2012/13 and beyond have not yet been confirmed.

19. The table below shows a breakdown of all British Government spending in 2010/11 on scholarships for people to study in the UK.

Table 3. British Government spending on scholarships for foreign students

	2010/11
DFID *(CSFS ODA)*	£17,494,000
FCO total spend on scholarships[236]	£16,929,000
Of which ODA	£12,400,000
BIS *(CSFS non-ODA)*	£499,000
Scottish Government *(CSFS non-ODA))*	£70,000

Q4. How much of the UK aid budget is devoted to helping countries combat climate change?

20. The Spending Review allocated £2.9 billion of ODA to an International Climate Fund (ICF) over the next four years. This fund represents approximately 7 percent of total UK ODA for the four years 2011-14.

21. All DFID spend specifically on climate change is through the ICF. Of the £2.9 billion, £1.8 billion is allocated to DFID, £1 billion to the Department of Energy and Climate Change (DECC) and £100 million to the Department for Environment, Food and Rural Affairs (DEFRA).

22. The purpose of the ICF is to support international poverty reduction by helping developing countries to adapt to climate change, take up low carbon growth, and tackle deforestation. Some examples of programmes funded through ICF include:

- the Forest Governance, Markets and Climate Programme which aims to protect 39 million hectares of forest,
- the Partnership for Market Readiness to increase the capacity for developing countries to design and implement carbon market-based instruments
- New public-private partnerships to harness private finance for tackling climate change. We aim to secure up to £3 of private investment for every £1 of public money spent.
- the Climate and Development Knowledge Network which will support up to 40 developing countries to build their knowledge, capacity and action plans on climate change.

[236] This total figure includes ODA eligible Chevening funds, non-ODA Chevening funds and the Marshall Scheme funds which is funding for students from the United States. All FCO scholarship spending which is ODA-eligible is done through the Chevening scheme.

23. ICF activities such as the ones outlined above have potential for great impact in developing countries. For example, building embankments and shelters, promoting climate resilient crops and improving access to safe water can enable an estimated 15 million people in Bangladesh to protect themselves against the effects of climate change and natural disasters. Investment in forestry in Nepal could halve the deforestation rate in programme districts and assist an estimated 560,000 vulnerable households in becoming more resilient to the effects of climate change.

24. The ICF will aim for a balanced allocation between adaptation (50%), low carbon development (30%) and forestry (20%). This split will be kept under review so that it is responsive to new opportunities in developing countries, the climate negotiations, and ongoing assessment of impact and value for money across the three themes.

25. So far £417m of the ICF has been allocated (£385m from DFID), with just over 30% of that on low carbon development. Proposals for the remainder of the fund are under consideration.

Received 6 September

Department for International Development; Foreign and Commonwealth Office; and the Ministry of Defence—Written evidence

CONFLICT POOL: INFORMATION NOTE

Overview

1. The Government's objective of helping to tackle conflict and instability overseas means drawing together all of the development, diplomatic and defence tools at its disposal. The National Security Council (NSC) has set the strategic direction through the Strategic Defence and Security Review. The more recent Building Stability Overseas Strategy describes in more detail how the Government is going to meet its commitments to prevent and tackle conflict.

2. The Conflict Pool is the principal mechanism by which the Government allocates joint resources in support of BSOS objectives. It focuses on discretionary conflict prevention, stabilisation, and peacekeeping activities. Its resources for 2011/12 to 2014/15 were set by the 2010 Spending Review through a joint conflict settlement. This settlement is additional to departmental budgets, and is managed jointly by the Department for International Development (DFID), Foreign and Commonwealth Office (FCO), and Ministry of Defence (MoD). It brings together diplomatic, defence and development capabilities into an integrated, cross-government response to instability and conflict overseas. The Foreign, Defence and Development Secretaries agree the Conflict Pool allocations with NSC colleagues.

History

3. The Africa Conflict Prevention Pool covering sub-Saharan Africa and the Global Conflict Prevention Pool covering the rest of the world and cross-cutting thematic issues, were established in April 2001 in response to a series of cross-Government reviews of conflict prevention work. These concluded that the UK's contribution could be more effective if it were coordinated across departmental boundaries and focused more on conflict prevention, in addition to conflict resolution and post conflict reconstruction.

4. The ***Conflict Pool*** was created in 2008 from the merger of the Africa and Global pools. A separate instrument, the Stabilisation Aid Fund, was established in the same year to support stabilisation planning in Iraq and Afghanistan. This latter Fund was merged into the Conflict Pool in 2009.

Purpose

5. The Conflict Pool aims to improve the effectiveness of HMG's engagement by bringing together the departments traditionally involved in conflict prevention work: DFID, FCO and MoD. The mechanism requires the three departments to conduct joint analysis, establish shared priorities and design and implement joint conflict prevention and management programmes on the ground. The Conflict Pool aims to fund innovative work to influence broader HMG policy and mobilise support from other international actors.

Funding (including Peacekeeping Budget)

6. The Strategic Defence and Security Review announced an increased commitment to conflict prevention and poverty reduction, focusing on tackling threats at source in those fragile and conflict-affected countries where the risks are high, UK interests are most at stake, and where we know we can have an impact. The Spending Review reflected this commitment, with conflict resources set to increase annually until 2014-15.

7. The joint settlement on conflict resources provides a single funding source for two separate budgets – the ***Peacekeeping Budget***, which pays for the UK's assessed (i.e. obligatory) contributions to UN peacekeeping and certain other assessed costs; and the ***Conflict Pool***, which covers HMG's discretionary conflict prevention, stabilisation and peacekeeping activities.

8. Both the Peacekeeping Budget and the Conflict Pool spend a mix of official development assistance (ODA) and non-ODA resources. This enables the Pool to support both civilian and military inputs for conflict prevention and stabilisation activities. It also means that the Conflict Pool contributes to the Government's commitment to spend 0.7% of GNI on official development assistance by 2013.

Table 1 summarises the 2010 Spending Review settlement.

Table 1: Conflict Resources: Treasury Settlement (£million)

	2011-12	***2012-13***	***2013-14***	***2014-15***
Peacekeeping (non-ODA)	374	374	374	374,
Conflict Pool	**256**	**270**	**290**	**309**
Of which:				
ODA	130	150	175,	200
non-ODA	126	120	115	109
Total Settlement	**630**	**644**	**664**	**683**
of which ODA	130	150	175	200
of which non-ODA	500	494	489	483

9. The Conflict Pool is the first port of call should assessed UN peacekeeping costs exceed the allocation in any given year. For 2011/12, £76 million, of which about £52 million will be reported as ODA, has been transferred from the Conflict Pool to the Peacekeeping Budget. This leaves a balance of £180 million available for discretionary activities. Expenditure is reviewed quarterly and the balance of resources between the Peacekeeping Budget and the Conflict Pool is adjusted if necessary.

Management

10. The joint conflict settlement is overseen by the Building Stability Overseas Board. The Board is responsible for the Building Stability Overseas Strategy, the Conflict Pool, the tri-departmental Stabilisation Unit, and the UK's contribution to international peacekeeping.

The Board comprises Directors from DFID, FCO and MOD. The chair rotates; and is currently held by DFID.

11. The Board allocates funds to six tri-departmental Programme Boards covering each of the programme strands, set out in paragraph 14 below. Each Programme Board is responsible for joint decision making and oversight of programme delivery, and is chaired by a director-level or Head of Department Senior Responsible Owner. Decisions on programme and strategy are taken tri-departmentally. Each project is managed by one of the three departments, with disbursement handled through that department's systems.

Programme strands

12. There are six programmes within the Conflict Pool. Five are regional: Afghanistan; Africa; Middle East / North Africa; South Asia; and Wider Europe. The sixth strand is thematic: Building Stability Overseas, Strengthening Alliances and Partnerships, which supports activities within the UN and other organisations. From this financial year, the Conflict Pool also funds the tri-departmental Stabilisation Unit which supports UK civilian deployments such as those to Helmand province in Afghanistan, southern Sudan, and Somalia. The Pool retains a reserve, £7 million this year, to cope with in-year pressures such as the rising costs of international peacekeeping missions and exchange rate fluctuations. This year's reserve has now been allocated to the programme for Libya.

Table 2: Programme Spend 2009/10 and 2010/11; Allocations 2011/12

Programme/£000	2009/10	2010/11	2011/12
Afghanistan	-	75,312	68,500
South Asia	70,001	16,214	15,500
Africa	43,222	41,411	33,100
Middle East/North Africa	17,635	11,195	18,400
Wider Europe	31,671	29,976	27,500
Strengthening Alliances and Partnerships	6,342	5,602	5,000
Stabilisation Unit	-	-	12,000
TOTALS	**168,871**	**179,710**	**180,000**

13. Allocations for 2011-12 are based on an assessment of countries at risk of instability where UK national interests are most engaged. Resources are prioritised to countries and issues that are high on the NSC's agenda.

The Future of the Pool

14. In light of the Building Stability Overseas Strategy, four significant changes to the Conflict Pool are planned:

- creation of an Early Action Facility, a reserve fund that will improve our ability to take fast action to prevent a crisis or to stop it escalating;
- greater multi-year funding for programmes;
- an enhanced focus on early warning and early response, based on the Cabinet Office assessment of UK interests; and,

- categorisation of activities into three broad themes: (i) free transparent and inclusive political systems; (ii) security and justice sector reform; and (iii) capacity building of local, regional and multilateral institutions.

15. In addition, the Conflict Pool's resource allocation procedures are being strengthened to sharpen the focus on results and value-for-money, aligned to the priorities identified in the Building Stability Overseas Strategy.

Department for International Development
Foreign and Commonwealth Office
Ministry of Defence

16 August 2011

Department for International Development; Foreign and Commonwealth Office; and the Ministry of Defence—Oral evidence (QQ 169-205)

Evidence Session No. 6. *Heard in Public.* *Questions 169 - 205*

TUESDAY 6 SEPTEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Hollick
Lord Lawson of Blaby
Lord Levene of Portsoken
Lord Lipsey
Lord Moonie
Lord Smith of Clifton
Lord Shipley

Examination of Witnesses

Witnesses: **Sue Wardell**, Director Conflict, Humanitarian, Security and Middle East, Department for International Development, **Conrad Bailey**, Head of Conflict Department, Foreign and Commonwealth Office, and **Steve McCarthy**, Director International Security Policy, Ministry of Defence.

Q169 The Chairman: Good afternoon and thank you for coming. I am sorry about the slight delay, but this is our first day back and we had some business to attend to. It is just possible that we will have a vote—I am not sure whether we will or not—in which case we will have to break during that period. I do not underestimate the magnitude of the task that you face. We have some tough questions to ask of you, but that in no way undermines our recognition of the difficulties—we want to get a true appreciation of the difficulties. When you first speak, would you please give your name et cetera and would you please speak up loud and clear for the webcast and the shorthand writers? Most of our questions could be answered by all of you, but if you are happy with the answer that is first given, please do not feel that you have to repeat it. Would anyone like to make an opening statement, or should we go straight to questions?

Sue Wardell: Straight to questions.

The Chairman: Thank you very much. As you know, we are focusing on international aid in this inquiry, so we will mainly be asking you about issues of international aid in relation to your responsibilities. I know that you have sent us an information note, which is very helpful, so thank you for that, but I wonder if I could begin by asking a very general question, really for the sake of the record. The Conflict Pool is a relatively new institution. Could you briefly describe the origins of the pool and how it works to contribute to meeting the Government's broader foreign policy, security and, in particular, international development objectives?

Steve McCarthy: Chairman, if I may, I will answer this one. I am Steve McCarthy, the Director of International Security Policy in the Ministry of Defence. The Conflict Pool's origins go back just over 10 years to the creation of two separate funds—the Africa Conflict Prevention Pool and the Global Conflict Prevention Pool, both of which were created in 2001. They were merged in 2008 to form the basis of the Conflict Pool as we know it today. In addition in 2008 the Stabilisation Aid Fund was established to support stabilisation in Iraq and Afghanistan and that, in turn, was merged into the Conflict Pool in 2009.

The pool was created in the first place to reflect a growing realisation that our experiences particularly in the Balkans and later in Iraq showed that the UK's contribution would be much more effective if there was proper pan-Whitehall co-ordination of the way in which we engaged in conflict prevention activity. But the momentum for the Conflict Pool as it is today was really established by the SDSR roughly a year ago, when it was published, which committed to this integrated approach between the three departments represented here—DFID, the Foreign Office and the MoD. It also committed to doing two other things: first, to increase the size of the Conflict Pool; and, secondly, to publish a new Building Stability Overseas Strategy, which, as you all know, was published just before the summer.

It is the BSO strategy, so-called, that answers the second part of your question, which is how the Conflict Pool ties into government policy objectives. It sets out very clearly, I hope, the way in which the department intends to respond using diplomacy, development and defence aspects of international co-operation to try to improve stability overseas. Our view is, broadly speaking, that it is impossible to discern a difference in some countries between the three angles, which need to be brought together to give the stability that we need to see to prevent conflicts from arising at some point in the future. I will keep this short as a starting point, but that is broadly the history of how we got to where we are today.

Lord Lipsey: I do not mean this as a criticism, but it would be immensely helpful if, when you use an acronym—BSO or whatever—you could spell it out for those of us who are not as familiar with this material as you are.

Steve McCarthy: I apologise. It stands for Building Stability Overseas.

The Chairman: Does anyone wish to add anything to that opening remark?

Q170 Lord Lawson of Blaby: May I ask a supplementary on this? I quite understand that it makes a great deal of sense to find some device for diverting the excessive funds that DFID has to Foreign Office or defence purposes when Foreign Office and defence budgets are so stretched. I understand the logic of that completely, but what puzzles me about this is that the prevention of conflict is not a UK preoccupation alone; it is a global preoccupation. This is why, of course, after the war the United Nations was set up—it was done very much with this perspective. I have not seen anything about the degree to which there is co-ordination and co-operation between the United Kingdom, the United States and our European partners, or indeed the United Nations. This is put forward as a British objective, which seems to me to be curious—it is almost a post-imperial hangover. Pax Britannica was a wonderful thing, but we have moved on from that.

Steve McCarthy: Perhaps I might make two points in response. On your first comment, the Conflict Pool is a separate fund provision, direct from the Treasury. It is not a diversion of the funding for DFID, MoD or anyone else; it is a separate settlement. On the point about international co-operation, there are a couple of aspects. First, while I would be very cautious about implying any sense of conceit, the UK is a quite a long way ahead in its thinking on this compared with some other countries. We have an awful lot of interest from our colleagues overseas. Just last week, I was in the Pentagon talking to my US opposite number, who does the same sort of activity in part. I have also discussed conflict prevention activity and stabilisation activity with French, German and Norwegian colleagues, so there is an international community coming together on all this. The other thing, on which Conrad may wish to comment a bit more, is that the Conflict Pool also provides the funding for the UK's contribution to UN peacekeeping. In that sense, this is tied into an international dimension. On the underlying thrust of your point, which was whether the UK is alone in this, the answer is no. Are we at the forefront of this activity? Yes, I think that we probably are. We are seeing a lot of international interest and we are trying to encourage that.

Q171 Lord Lawson of Blaby: And is it satisfactorily co-ordinated?

Steve McCarthy: I think that there is more co-ordination that we could still do. We are at the early days of that.

Sue Wardell: Perhaps I could just add one more point on this, if I may. The third part of the Building Stability Overseas Strategy brings out this point about working in partnership with others, saying that we cannot reduce conflict overseas by working bilaterally; we have to work with the United Nations, the European Union and other member states that have an interest in working with us on these issues. That is very much part of the thrust of the Building Stability Overseas Strategy.

Conrad Bailey: I am Conrad Bailey, Head of the Conflict Department in the FCO. I would add two points. First, we work very closely with the UN on these issues. Indeed, one of the sub-programmes within the Conflict Pool is focused on strengthening alliances and partnerships. Much of the resource that goes into that goes into working with the relevant bits of the UN to help to build their capacity so that we can address these conflict issues with them. The second thing that is probably worth bringing out is that not only do we try to develop the relationships with, if you like, our established allies and partners in this field—the Americans and others—but we are also looking to work closely with some of the emerging powers very closely. Last week, I was in South Africa discussing building stability approaches with them. We have also entered dialogue with the Brazilians and others. So we are looking beyond our normal horizons.

Q172 Lord Hollick: One of the lessons from the invasion of Iraq was the inadequate planning for civil society after the war. To what extent is the Conflict Pool involved in forward planning? Are you, for instance, involved in what is going to happen in Libya?

Sue Wardell: Sorry, I forgot to introduce myself, Chair. I am Sue Wardell from the Department for International Development. The Conflict Pool is at the forefront of supporting planning for what we are calling stabilising Libya. There was an allocation made of £12 million specifically through the Conflict Pool to set out how we might approach stabilisation in Libya. Part of that was used to mobilise the stabilisation response team that went out to Benghazi—at the time we could not get into Tripoli. It comprised experts on things such as security sector reform, transitional justice and politics. It was joined by colleagues from around the world who also wanted to be involved in this and it put together a series of detailed papers on what might need to happen in terms of stabilising the peace. Those papers were shared with the National Transitional Council and informed a series of workshops that it has held on the issue. They were also shared with the United Nations, in particular Ian Martin, who arrived at the weekend in Tripoli to set up and lead the international response on stabilising Libya. That was very much based on the lessons that we have learnt about the importance of looking at everything that you do in every intervention that you make to see what its impact might be on the longer-term stability.

The Chairman: Now we will mainly be focusing on development aid, as is our requirement in this inquiry.

Q173 Lord Levene of Portsoken: Good afternoon. DFID has indicated that by 2014-15 about 30% of UK aid will be targeted to fragile and post-conflict countries. Allocations through the pool will represent a relatively small share of this total. What determines the allocation of resources between DFID's own budget and the Conflict Pool? Does that allocation reflect different intentions or approaches or different areas of specialisation?

Sue Wardell: As my colleague said, allocation for the Conflict Pool is a separate settlement through the resource allocation round. Therefore it is separate from DFID's budget. The money sits on DFID's baseline and is then transferred across to the other two departments as we agree specific projects. In terms of the difference between the money that DFID spends bilaterally and the Conflict Pool, for the money that DFID spends bilaterally our programmes and projects are set out in the Bilateral Aid Review. That was an exercise that was introduced by the Secretary of State when the coalition Government came in to do a root-and-branch review of what we were going to do in every country. Part of those allocations talk specifically about what we would do on conflict reduction in the countries where we were working. The Conflict Pool, which is a much smaller sum of resources—DFID spends about 9% of the total resources of the Conflict Pool—is useful in that that is where we look with the Ministry of Defence and with the Foreign Office at interventions that benefit from a tri-departmental approach. They bring together approaches that we can fund through official development assistance and approaches that do not qualify as official development assistance. That can be military aid. One example that I will give you is Sierra Leone, where through our bilateral programme we have been working on police reform, but you need to look at police reform in the wider security context. Through the Conflict Pool, we have been able to fund work on reform of the military. Those two have come together and improved the overall quality of the impact that we have been trying to secure.

Q174 The Chairman: Does this focus on fragile and post-conflict states mean that there has been a change in the overall ODA allocation of aid in different directions? I know that some of it goes over to the Conflict Pool, but if you take it as a whole, does it suggest that there has been a change in priorities?

Sue Wardell: DFID now has 28 priority countries—South Sudan is a new country. Twenty-one of those countries are classified as fragile and conflict-affected states. They do not all have conflicts but they are fragile states and vulnerable. We have been involved in the majority of those for some years, so it is not as if we are taking on lots of new ones. What has happened is that we have withdrawn from or closed programmes in a number of countries where we have graduated from because they have moved out of being low-income countries; they have become middle-income countries and it was felt that we no longer needed to provide assistance. The Secretary of State was very concerned that we should focus on fragile and conflict-affected states not least because 1.5 billion of the world's poorest people live in those countries. At the moment, we spend about 23% of our resources there. There is a shift in that we are going to try to increase that to 30%, so a greater share of bilateral resources will be going to those countries. Part of that is because we are going to have fewer of the non-fragile countries, but also because there is an effort to really scale up what we are doing in the existing countries.

Q175 Lord Lawson of Blaby: Could you send us a note that lists all those countries that used to be recipients of UK aid but which you have discontinued because they have made the grade?

Sue Wardell: Yes, we can do that.

Q176 Lord Smith of Clifton: How are decisions on engagement and funding made within the pool? In particular, how are potential conflicts of interest between the three departments' agendas reconciled—for example, when the developmental case is weak but the security imperative is very powerful?

Conrad Bailey: I will take that question. We start off with a shared budget, which is allocated under the spending review. Through the production of the Building Stability Overseas Strategy we now have a cross-government strategy that provides us with a clear baseline. Many of the sorts of debate that you might have expected us to have between departments were ironed out as part of the process of developing that. As a relative newcomer to this area, I think that one of the striking things is that there are very few areas of significant difference along the lines of the difference between diplomacy, development and defence assistance. Where we have disagreements, the way in which the process works is quite straightforward. There are various regional programmes. Each of those is chaired by a senior official from one department with officials from the other departments on it. They will try to reach agreement on a particular case at regional level, because that is the best place for those trade-offs to happen. By and large, that is what happens. On a very few occasions, they will be unable to reach agreement. In that case, they will escalate those issues to the Building Stability Overseas board, of which we are the members.

Since May this year, there have been a couple of occasions when this has happened, which give quite a good illustration of how we work through some of these issues. One was when the South Asia Programme asked for more resources to fund staffing costs to deliver the programme. The case was not particularly well articulated, but from an FCO perspective I felt quite strongly that it was important that we provided those resources in order to allow the programme to be properly managed. I think that it is fair to say that my two colleagues here did not feel that the case was sufficiently robust and we reached a compromise position where we agreed that we would continue funding for some of the project support staff until the end of this financial year and give the teams a chance to make another case in the next bidding round that was perhaps more robust, which would either survive or not.

In a case such as that, we reached agreement. If we had not been able to reach agreement, we would have escalated the issue to ministerial level to be agreed. However, where there have been disagreements, and that is an example, they have tended to be on whether something is value for money or whether the case is sufficiently well founded rather than fundamental differences of approach, because we have an underlying strategy that we have agreed.

Q177 Lord Smith of Clifton: That is all very well in relatively stable situations, but as we know the world is not now very stable and is liable to be volatile. When things blow up, how does the pool respond to that? Do you all go your separate ways and come together later?

Conrad Bailey: Perhaps I could give another example, which is the decision to send the stabilisation response team that we were talking about earlier to Libya. The decision was taken at ministerial level to send this international stabilisation response team. We very rapidly got together a cross-government team to work on this issue to provide us with the advice that we needed and we identified the sources of funding from within the Conflict Pool.

We then drew on our Stabilisation Unit, which is a cross-government unit that was ideally created and designed to help us to address these sorts of rapid onset issues, and came up with the process. Yes, there were certainly some pretty robust discussions around how we should manage the unit, what the duty of care to staff was and those sorts of issues, but the pressure of time and the fact that we had an established set of relationships and an established board allowed us to come to an agreement and work through the differences. It worked well and we reached agreement in about 17 days, including recruiting the staff.

Q178 Lord Smith of Clifton: May I press you on that? If something blows up, presumably it goes defence, FCO and then DFID in terms of time horizons—defence would arrive pretty quickly.

Steve McCarthy: Not necessarily. Every example is going to be different, of course, but most of the situations where the Conflict Pool would be an appropriate means to fund whatever activity we are looking at are not likely to be down one or other of our specific channels, as it were. Indeed, if that were the case, I would expect that, if it was the MoD pressing the reverse of Conrad's example, my colleagues here would be arguing that it was not an appropriate use of the Conflict Pool. In practice, we start with the presumption that the Conflict Pool is there to fund activity that all three of us would agree was necessary.

Q179 Lord Hollick: In the strategy paper on Building Stability Overseas, the Government stress the importance of evidence-based policy-making. What exactly do we know about aid effectiveness in post-conflict environments? How does the pool translate this evidence into practical action? Could you outline some of the key positive lessons that we think we have learnt?

Sue Wardell: Perhaps I could start on this and talk about general lessons and then my colleagues may want to give examples of particular projects that they want to cite on the Conflict Pool. We are getting better evidence on the effectiveness of aid in conflict situations, not least because the World Development Report, which came out earlier this year, presented a comprehensive review of all existing literature and evidence. That enabled us for the first time to get a global view on what works and what does not. Evidence is still emerging because this is a new area where DFID wants to invest more resources into trying to build up the evidence base. But I can give you some examples of what came out of the WDR and other research that has gone on about the impact of aid on conflict and whether it is worth investing in. Some of the evidence points out that the annual cost of one new conflict to a country and its neighbours is more than $64 billion. I might cite other figures. A recent study estimated the hypothetical cost of a medium-level conflict in Sudan as being about $228 billion over 25 years. Over 50% of that would be a burden on its neighbours and the international community. That is a significant cost. Paul Collier, who I know will be familiar to a number of you, has done quite a lot of work in this area. He has identified that aid is about twice as effective as normal in post-conflict situations. If you look at it in terms of aid's effect on growth in post-conflict situations, again, you have a 200% return on that investment. It is twice as effective. He also pointed out that, if you can increase per capita from $250 per head to $500 per head, you can reduce the chance of conflict occurring by 50% over a five-year period. That is just some of the evidence that aid can be effective in a post-conflict, conflict reduction situation.

Perhaps I could give you some examples of where DFID has supported investments in conflict situations which have helped. One that I would like to cite is in Basra. When we were still in conflict in Iraq, we set up a youth employment programme. We recognised that there were a lot of young unemployed youths who were starting to become disenchanted with what was going on and were being attracted to radical groups. We worked with local employers and we managed to get 200 of them to sign up to a scheme where the youth would be provided with vocational education and training for two months and then for the following 10 months they would get work experience placements to equip them with in particular the life skills that you need to be effective in the workplace. We managed to sign up nearly 500 young people, of whom 400 completed the one-year programme. We are now doing a longitudinal study to look at what has happened to them as a result. Some have stayed with the employers and some have moved on to set up their own businesses and so forth. We want to look at the conversion rate. That is one example of where investment in a conflict situation can bring about some benefits.

Conrad Bailey: I can give an example from Kenya, which is a good Conflict Pool example. In 2009, we invested £300,000 in establishing district peace committees at a local level. They were basically people linked up who were able to use their mobile phones and other things so that when they saw community stress, tension and violence breaking out they could report it and action could be taken to try to manage it. Similarly, during the constitutional referendum in 2010, we also provided funding. Going back and looking at the lessons from that, it is very clear that, not in every district—we set up 50 committees—but in a number of those districts, those committees were able to identify where tensions were likely to emerge. They could then allow action by civil society to take place to try to dissipate those risks by getting the leadership of various communities talking to each other, for example. That was a very good example of where we had a practical effect. What we have taken from that is the value of this sort of approach. There are a number of other projects in the Conflict Pool. There is one in the Fergana Valley in central Asia. There is one on the border between Sudan and South Sudan. Again, they are about encouraging these levels of community dialogue. We have managed to build on that. Interestingly, others have also taken some of the lessons. I had a meeting with a Filipino and a Kenyan delegation at the same time a few weeks ago where they were very keen to explore what we had done with the Kenyans and see how that might apply to the Islamic secessionist movements in the southern Philippines.

Q180 Lord Hollick: In the light of these data, to what extent have you redirected your funding? That is my first question. My second question is: given the substantial figures that you referred to earlier, are you arguing that more money should be taken out of the mainstream DFID budget and put into post-conflict situations?

Sue Wardell: In terms of redirected funding, the Building Stability Overseas Strategy draws on this evidential base in that it sets up three objectives for the funds under the Conflict Pool to address. The first is building accountable institutions. One strong lesson that comes out of the World Development Report is that if your institutions are representative—if they listen and respond to their citizens and if their citizens feel that they can be heard—they are more likely to be able to arbitrate between conflicts that come up and to prevent them from becoming violent. Building accountable institutions is a very important role in conflict prevention. The second is access to security and justice. If people feel that the courts are fair, that the police are going to be responsible and will look after their human rights and that if they have a grievance they can get retribution, they are less likely to take the law into their own hands, which again reduces the possibilities of conflict. The third is about building up the capacity for institutions at the local level, the regional level and the international level to do conflict management and to be effective. The Government specifically said, through the Building Stability Overseas Strategy, that they will focus the Conflict Pool much more on these areas, rather than having the very wide focus that there was before.

In terms of redirected funding, I come back to the point that I made before. In saying that we want to increase our funding to 30% in fragile and conflict-affected states, DFID is saying that these states are important. It is important to make sure that we are looking after the interests of the 1.5 billion who are the most disadvantaged. Secondly, we are saying that this is a moral imperative but it is also good for the UK. If these fragile states deteriorate into conflict, that conflict can spread across borders, with significant costs, and can have international repercussions and affect the UK, so this is important for the UK—it is in our interests as well. Because of that, we are looking at increasing resources. We are not diverting resources from other areas as such; we are just increasing our focus on these countries. It is important that DFID does that, as a lot of other donors will not necessarily invest in some of these countries because they find them very difficult to work in. For example, the Democratic Republic of Congo and Yemen are countries that a lot of the other donors will not look at because they are much more difficult and challenging, but they are very important for us to engage in.

Q181 Lord Lawson of Blaby: Of course, these other donors may be quite right. The present Government have attached more importance than probably the previous Government did to evidence-based policy-making in this field. Where is the evidence that this policy makes sense? You quoted Paul Collier, who is certainly a big figure in the aid world, but his estimates seem to be highly speculative. You yourself say in your Building Stability Overseas Strategy paper that "the overall evidence base and conceptual foundations for engagement in fragile states remain patchy, underdeveloped and, in some areas, contested". I suspect that these other donors take the view—as I say, they may well be right—that since the objective is to encourage economic development and to alleviate poverty and since there are plenty of countries that suffer from lack of economic development and from poverty that are not conflict or post-conflict states, you will get a much bigger bang for your buck and be able to do much more good for the taxpayer's pound if you divert to areas that do not have these conflict problems. So where is your evidence that you should do the reverse?

Sue Wardell: You are right that the evidence base is still evolving. As I think I said in response to a previous question, the World Development Report is very useful to all of us who are involved in this field, because it attempts for the first time to bring together all the evidence that is out there. It says that to be effective in conflict and fragile states the first thing that you need is an integrated approach. You must not look at it purely through a development lens, a diplomatic lens or a defence lens; you must bring the three perspectives to bear and look at it in an integrated way. That is one of the things that we are trying to do in our approach to this through Building Stability Overseas. The second thing that it says is that you need to build inclusive institutions. That is really important. You also need to look at security and justice. Another thread of evidence that is coming through is from an organisation of 17 fragile states that have got together and have been discussing what they think they need to help to lift them out of fragility. They have identified that these are the kinds of interventions that are needed, are worthwhile and have returns. Thirdly, we have evidence from some of the investments that we have made that aid works in these contexts and there is a return on it. I have given a couple of examples, but I can give you others, or, if you would like, we could give you a note on some of these examples in a bit more detail, which might be a better use of your time.

The Chairman: That would be helpful.

Sue Wardell: We will do that. We also recognise that the evidence base is still evolving, so we have appointed a senior research fellow on conflict. One of their roles is to synthesise all the evidence that is out there and ensure that the department is using the best knowledge available. Secondly, where there are gaps in evidence, they will commission more research. We have set up an international advisory group, made up of people from the World Bank—Sarah Cliffe, for example, who was one of the co-authors of the World Development Report—leading academics and private sector companies that have an interest in working in conflict-affected and fragile states, who meet with the three departments twice a year so that we can discuss with them what we are doing and what lessons are to be learnt and keep on trying to ensure that we are learning from experience and from our investments.

Q182 The Chairman: Given that these are fragile states, does it usually take longer to be able to demonstrate the evidence that what is done is effective?

Steve McCarthy: There are two points. The first is that that is exactly the reason why from next year we are going to try to set up some of these programmes on a multi-year basis. One issue that we have found was that when we had annual funding arrangements it was difficult at the end of each year to say, "Here is the difference we've made in a period of 12 months," as some of the programmes are inevitably going to take some time. There is also the side issue of value-for-money considerations, in that we expect some of these programmes over time to get more efficient and therefore cheaper. The more substantive point about that is that, since the nature of the game is conflict prevention, there is always going to be an element of judgment. As Sue has said, we are going to do everything that we possibly can to improve the quality and the robustness of the evidence and we will look at each of these programmes on a clear basis. Programmes will have to write a business case, state what they are going to try to do, prove that it is feasible and demonstrate the viability of their proposal. It is quite difficult to envisage a situation where you have a sort of control experiment, where we do not put the money and effort into a state that is in exactly the same circumstances as the state into which we are putting money and effort to see whether a conflict develops. In a sense, you are trying to prove a negative, which is quite difficult. But we absolutely take the point that the more robust the evidence that we can get, the better this process will be, because what this is about is delivering the results that we are trying to obtain at the end of the day.

Q183 Lord Lipsey: Before I come to my main question, will you clarify something that you said earlier? You said that Collier's evidence was that aid to conflict countries was twice as effective as other aid. Will you be a bit more precise about what you mean or he means by "twice as effective"?

Sue Wardell: I think that he is talking about the rate of return on your investment.

Q184 Lord Lipsey: Thank you. What I wanted to explore with you is what seems to me something of a tension in DFID policy. DFID rightly emphasises that you want to work with local partners and that you want the local partners to own the programme—that is the way it works best. Almost by definition in conflict societies, it is very hard to find local partners who are appropriate and easy to work with and who have not got other things on their mind such as shooting people they do not like. How in practice do you seek to reconcile those rather conflicting considerations?

Sue Wardell: Some of my colleagues appeared before you a few weeks ago and talked about the partnership principles that we apply in Government-to-Government relationships, which are the commitment to poverty reduction, human rights, public financial management and accountability—the four principles. Those very much govern our relationships Government to Government, but, as you rightly say, in some of the fragile and conflict-affected states that we work in we may choose not to work with the Government. An example is Burma, where we do not work directly with the Government. Those partnership principles would apply to the way in which we would engage with other partners. If we are working, say, with non-government organisations, we would look to see whether they had strong, robust financial management systems. We would also look to see whether they respect human rights and that their overall objectives are in line with what we are trying to achieve. We have to go for a much more diverse range of partners. We work with civil society. Some of the activities that we undertake under the Conflict Pool involve working with Parliaments, the private sector, faith-based organisations et cetera. We have to find a range of partners. We recognise that there is an issue of capacity here. One of the things that we think shows that there is a response to those capacity issues is that the world is starting to wake up to the importance of trying to deal with conflict and with fragility before it collapses into conflict, so a lot more people are looking at and working on this issue and more international capacity and knowledge are building up. If we cannot find local partners, we would perhaps look to regional partners; if we cannot find regional partners, we would look to international partners. One reason why in the Building Stability Overseas Strategy we emphasise building capacity to manage conflict at local, regional and international levels is this need to build up the capacity of partners to work with.

Q185 Lord Lipsey: But that is very difficult in a situation where political legitimacy itself is contested. I can only sympathise.

Sue Wardell: Yes. In those situations, we quite often have to work around some of the Governments in the countries that we want to help.

Q186 Lord Shipley: Could I move from stability to growth? I want to ask you about the capacity of UK or other aid directly to support sustainable private sector development and employment in these difficult environments. Can you give us examples of what successes there have been or what we have learnt from initiatives taken?

Sue Wardell: Again, the evidence is still evolving. This is one of the things that we will cover in the note that we will send back about examples of a where aid has been effective. I think I mentioned that there is evidence that investment in the growth area in fragile and conflict-affected states does reap returns. I could give you some examples. I mentioned the youth employment programme. Another programme that we ran in Basra—I cite Basra because it was in the middle of the conflict—was to set up the Basra Investment Commission to provide and build up local capacity to manage inward investment. As a result of that commission being set up, it was able to provide support to inward visits by prospective investors from the region and international investors. It worked with us on setting up in London an investors' conference, which attracted over 100 participants who were interested in looking at the longer-term potential of investing in Basra in particular and Iraq in general. It also provided support and assistance to local businesses that were looking at ways in which they could attract inward investment. That was so successful that the Iraqi Government decided to scale it up and set up a national investment authority. That is one example of where aid on growth has been successful.

Another example is in Sierra Leone. Five years ago, DFID gave a start-up grant to two men to set up ManoCap, which was Sierra Leone's first private equity fund. It received further support from the Commonwealth Development Corporation and other investors. Since then, through investments it has grown 800 additional jobs and generated just under $1 million of additional tax revenues for the local government. That shows how a small investment for two people has grown.

One of the constraints on growth can be lack of access to bank funds and bank accounts and another example that I would cite is that DFID is working with the Gates Foundation to support aims to use mobile phones to enable people to gain access through that technology to banking services. The target is 30 million people. Those are some examples of how investment can stimulate growth.

Q187 Lord Shipley: I understand that it has been stated that by 2015 in Somalia, 45,000 jobs will have been created through the aid that we are giving. I am wondering whether having firm numbers like that is a help, because that is four years away. Can that be delivered? Are those numbers robust? If so, they are very impressive.

Sue Wardell: The numbers that you mention come from the Bilateral Aid Review. One of the things that the coalition Government decided to do when they came in was a root-and-branch review of all DFID's country programmes. Rather than focusing on, as in the past, the amount of money that each country would get and then putting forward plans for what you would do with it, the Government said that that was the wrong approach. They wanted to ask, "What are the results that you think you can deliver and how much will those results cost? What are the alternatives to your ideas on presenting those results?" It was a rigorous process. It involved external peer review. People from outside DFID with experience in development came in and challenged the proposals being made. Every single country programme went through a scrutiny panel. There was an internal scrutiny process that involved advisers from across a wide range of sectors reviewing the documents. They then provided a memorandum to the external security panel and conducted a discussion with the country heads. Out of that came the final agreement on the targets that were set and the results that were claimed. The 45,000 jobs claimed for Somalia went through that process. At this moment in time, we are committed to delivering that result. Aid is an uncertain business, so I would not want to say that it will definitely be achieved. It may be exceeded or it may not be, but we did not pluck the numbers out of the air. That is what I am trying to say. They were carefully worked out and a lot of challenge went into putting those numbers forward.

Q188 Lord Shipley: I understand, but does the peer review take account of the absence of solid institutions of government?

Sue Wardell: Very much so. I can talk about Yemen, which is one of the countries that I saw go through a review. We recognised that we had a fragile state that was in risk of failing. In fact it has gone down since. When we had the peer review, there was a lot of challenge about some of the institutions that we were going to be using to deliver that aid. One was the Social Fund for Development, a kind of parastatal, which provides a lot of the social welfare assistance—for schools, healthcare and social welfare payments—that we support in Yemen. We were questioned quite rigorously and had to provide strong evidence about the capacity and durability of that organisation. Would it survive if the situation in Yemen deteriorated? We had evidence that it would. So far, despite the very difficult situation in Yemen with the increasing humanitarian crisis, the Social Fund for Development is still able to deliver a lot of what we were funding it for.

In other areas, we are reviewing some of what we said might be delivered because of the changing situation. But the results are over a four-year period. When we were putting the results forward, we realised that there would be cycles. When you are working in fragile states—this is something that comes out in the World Development Report—there is not a straight line between fragility, conflict and development. As states go through cycles, they will emerge out of conflict and then go down into it again. Therefore, we have to realise that we need to look at this in a longer-term perspective.

Q189 The Chairman: In answers to recent questions, you have been talking about aid through government organisations, non-governmental partnerships, the private sector and individuals and you have given specific examples. Can you give us any idea of the actual proportions of aid that go between them?

Sue Wardell: I cannot. I am not sure if those types of statistics are available, but we will have a look and give you what we can on that.

Q190 Lord Hollick: To what extent do you work with the British corporate sector to encourage it to invest, and maybe you co-invest with it, in establishing new businesses in the countries?

Sue Wardell: Again, a couple of weeks ago my colleagues talked about the fact that the Government have pushed DFID to become more private sector-friendly. We have a private sector investment strategy. We have a new private sector development department. One of the aims and objectives of that is to increase our understanding of what would encourage the private sector to invest in some of these fragile countries. We recognise that getting investment in is probably the best way for them to make progress out of poverty. We have started to have those discussions. One of the other things that we have done with the conflict reference group that we have set up is to bring in private sector companies that have an international profile and are interested in working in fragile states. Again, they can challenge us and inform us of their needs in terms of what can help them in investing in some of these very fragile countries.

Q191 Lord Hollick: Has anything tangible come of that dialogue?

Sue Wardell: Some of the activities that we have undertaken on enabling the environment for growth in the past have had tangible benefits where we have improved the investment climate for doing business. Tajikistan was one of the top performers in improving its investment climate for business the year before last in terms of its shift upwards. That was as a result partly of funding that we were providing through the International Finance Corporation, which is a private sector wing of World Bank, on how to improve the regulatory environment, how you make it a level playing field and how you deal with backhanders, corruption and so forth. We have some evidence that that is working, but clearly what we need to do is to harness more the entrepreneurial know-how and knowledge of the international private sector about what works and to listen more to them about what would make it easier for them to invest in some of these countries.

Q192 Lord Best: My question is about corruption. The Building Stability Overseas Strategy is pretty well silent on this issue and yet in these fragile and post-conflict countries surely we all know that misappropriation of funds is endemic. How does the Conflict Pool reconcile this reality with the work that you want to achieve?

Conrad Bailey: First, we recognise that there is inevitably this risk of corruption. We use the normal methodologies that we use elsewhere in government, from an FCO perspective. Once the projects have been initiated, they are managed between our three departments. We have very clear guidance for officials and diplomats in post on how to apply the Bribery Act 2010. We have clear whistleblowing procedures. When we are contracting for particular activities, we apply lots of codes and procurement ethics that seek to address these issues. What is perhaps slightly different about some of the Conflict Pool projects compared with some of the others is the very active level of engagement we tend to have on the ground with the projects. They are often for small sums of money, so the diplomats in the embassy, the defence attaché and the DFID offices often have a rather more hands-on approach. They are supported in taking this forward and ensuring that we really can work through these things with a network of what we call regional conflict advisers who can provide that advice. Back in the UK, mainly, we have project managers who try to ensure that we address these issues as best we can. However, the risk is obviously there.

Sue Wardell: The way that the Conflict Pool investments are appraised is through a tri-departmental discussion. The Conflict Pool has six areas of programme intervention. They have a team that is headed by a director, who then has directors from the other two departments—from the FCO, the MoD or DFID. They will scrutinise every investment proposal that comes to them. There is a very high level of scrutiny. That kind of peer review challenge also helps to identify potential corruption risks that may evolve with investments and we discuss how to deal with those. The other point that I would like to make is that you are absolutely right that these fragile and conflict-affected states can be vulnerable to corruption. There are risks involved in investing in those countries. But the World Development Report said that we always have to balance the risks of investment against the risks of not investing. If you do not engage in some of these countries and say that it is too risky so we cannot invest, what will happen to them if they are left to their own devices? That is something that we always have to balance up.

I understand that my colleagues, when they met you a few weeks ago, talked about DFID's approach to corruption. As Conrad rightly said, when the Conflict Pool bids are agreed, the individual department takes responsibility for managing the delivery of the individual projects. Certainly, in the same way that the FCO has detailed procedures for managing risk and wastage of funds, DFID also has firm and strong procedures that we employ, be they to the bilateral programme or the Conflict Pool investments.

Steve McCarthy: As do we. Perhaps one of the slight differences with MoD-proposed projects, although we try not to use those sorts of labels, is that very often we fund the involvement of some MoD personnel in training or activity in the field. That is one of the advantages of defence's involvement in this programme. Sometimes you get more traction in a country because you are dealing on a uniform-to-uniform basis. For example, if you have a particularly militaristic society, people respect and talk to people who are wearing uniforms.

In that context, we are slightly more within our own control. Where we are putting funding into private companies or some other means, we use standard MoD procurement rules to try to ensure that we avoid the risk of corruption as best we can.

Q193 Lord Best: It may be the military themselves who are the source of corruption and going just uniform to uniform may not do it. You say that you do your best, but is there a point at which one has to say that enough is enough and we cannot operate in this country with the governance in the state that it is in?

Sue Wardell: I do not think that we ever say that we cannot operate in this country with the governance in the state that it is in because that would imply holding poor people hostage to their poor governance. What we will say is that we will not invest in certain areas or we will not work with certain parts or certain institutions like the Government because we do not have any confidence in their ability to manage funds in an accountable way. An example is Pakistan, where we stopped disbursement of a £15 million tranche because of suspected fraud. After it was investigated, we decided that we would not release the £15 million. We released £5.1 million because we knew that we could account for those funds and that the results to be delivered by them would be effective. So we went ahead with that but we did not go for the full amount that we had originally agreed.

Another example is Guyana, where we were investing in the water sector. When we uncovered a fraud in the management of the company that was administering the water programme, we immediately stopped the resources going in. We had a discussion with the Government. We sent in, at their request, our own internal audit unit. The National Audit Office sent in a team to do a full investigation. We came up with an action plan as to what they had to do, which included getting rid of the senior official in charge of the company and a couple of the senior members of staff and putting new people in. They had to make a whole range of changes to their procedures. Funds were only released in tranches once they had made progress against some of those specific, clearly identified strategies and changes that we insisted on in order to safeguard the funds. We take it very seriously.

Q194 Lord Lawson of Blaby: You say you take it very seriously, but that is not evident either from the BSOS paper or, if I may say so, from the evidence that we have heard this afternoon. When you say, for example, that you have to strike a balance between aid and the effect of not giving aid, if the aid is in effect financing corruption, which is obviously not your intention but may be a consequence, then not giving the aid may be very much the right thing to do. En passant, it would be helpful if we could have a list of those Governments to whom we no longer give aid in any shape or form because they are so corrupt. We have had a lot of evidence on this, including from Michela Wrong, which you have no doubt seen. She is a considerable expert on Africa and has considerable experience. She says, "ODA and corruption always go hand-in-hand … There is simply no way out of this conundrum … DFID, in my experience, routinely plays down the importance of this issue——the biggest existing challenge to ODA". That is what she says. We have had a lot of other evidence from experienced people in these countries which bears that out. Your BSOS document and the statement you have given today somewhat bear out that you play down the importance of this issue. If you accept that it is important, what are you doing about it?

Sue Wardell: We accept that corruption is an important issue. It is important because it affects people's lives. It does not just affect the security of the UK aid funds; the security and the lives and opportunities of poor people in their own countries are affected if they have to put up with petty corruption.

Q195 Lord Lawson of Blaby: So what are you doing about it? That is my question.

Sue Wardell: At a country level, we have anti-corruption programmes. We do things such as improve the quality and transparency of public services so that people cannot be bribed. We look at ways in which we can ensure that people are paid a proper wage so that they do not have to revert to bribery in order to supplement their incomes. We look at support for anti-corruption commissions where they are set up and help them to learn from international best practice about how to deal with it. When we are looking at investing in government systems, we put in a lot of resources to public financial management to try to strengthen financial management systems so that they are more transparent, more accountable and less likely liable to corruption. Those are just some of the examples of the work that we do to try to reduce corruption in the countries where we are working.

Q196 Lord Smith of Clifton: Does that actually reduce the amount of corruption overall or are you just putting an Elastoplast on this little bit of corruption here and it breaks out somewhere else? Is it a bit like neighbourhood watch—it just passes the criminals on to the next parish?

Sue Wardell: I do not consider that that is the case. When we are looking at public financial reform, we look at the whole of the government system. We are making the government accounting and financial system, revenue system and expenditure system much more transparent. We do not do this on our own. We work particularly with the World Bank and the International Monetary Fund, which are the experts in this field. When you put in place those systems, they go across the whole of government activity and therefore they have an impact across all government expenditure—even expenditure that is not directly on the development side. It would have an effect on military expenditure as well. If we concentrated only on one area, we know that it would not necessarily deal with the whole government system. When we look at public financial management, we tend to look at the whole of the Government's approach.

Q197 Lord Moonie: As the cases of Afghanistan and Iraq have shown, a significant portion of aid delivery in fragile environments is delegated to international agencies, specialist NGOs and/or contractors. As DFID increases its support to fragile and post-conflict states, this delegation may well increase. Do such organisations have the capacity to deliver effectively our increased commitment to fragile states? What audit do you carry out to see that they do?

Sue Wardell: A lot of organisations work with DFID, including from the private sector, non-government organisations and multilateral organisations, in fragile and conflict-affected states. Let me start by talking about what we do with the multilaterals. We undertook a multilateral aid review as part of looking at whether we were getting the most effective and best value for money out of our partnerships. That looked at the performance of the multilateral institutions, particularly in fragile and conflict-affected states, as well as other parts of their business. As a result, we have a very good evidence base, confidence and knowledge of which institutions are more effective in those situations than others. We also have a reform agenda for each multilateral institution, which we have agreed with them to improve their performance in areas where we feel that there is weakness. With the multilateral system we are working in a very structured way in addressing those issues.

With NGOs, we carry out the same kind of due diligence checks as if we were going to put funding through a private sector consultancy. We look at whether or not they have the right staff with the right skills and experience and whether they have a track record of delivery.

We look at whether their costs relative to the returns that we are getting look to be reasonable and whether they have the right objectives in terms of what they are trying to achieve. We would look at those very closely in terms of assessing their ability to work with us effectively. Similarly, with the private sector, a number of consultancy firms working in this area have built up quite a lot of expertise over the years.

Fragile and conflict-affected states are not the minority group in terms of DFID's country coverage. They are 21 out of 28. They are 75% of the countries we are working in and we have been engaged with them for some years. Not only have we been engaged with them, but the international communities have engaged with them, so there is a lot of experience of working in these countries. All the time, these organisations themselves are reflecting on the lessons learnt. That is why the World Development Report was so useful in capturing those lessons, telling us what we needed to do and telling them what they needed to do to be more effective in these contexts.

Q198 Lord Lawson of Blaby: I would like to come back to the importance of the evidence-based aid programme. This is intimately linked with the question of the evaluation of aid and the disbursements that you make. What precisely are the criteria that you use in this area of fragile and post-conflict environments? When I say "criteria", I really mean criteria, not what you take into account—I am sure that there are all sorts of worthy things that you take into account. But what are the criteria so that you can say, "These criteria are not being met and therefore we are not advancing the money"? In particular, what examples can you provide where the criteria have not been met and therefore the UK has disengaged from its support to fragile states? You can always find some excuse for giving money, but the question is whether you really have criteria.

Sue Wardell: I will try to answer that question. We do not have a list of generic criteria beyond what I explained about the partnership principles. In other words, are they committed to delivery of the MDGs and to poverty reduction? Are they committed to human rights? Are they accountable? Are they transparent and accountable to their citizens? These are the partnership criteria that we use to make an assessment about whether or not we should invest in an institution to help a particular country. Sometimes because of those criteria, we find that we have Governments who are not committed to human rights. We have Governments who are not transparent and do not have strong public financial management. As a result of that, we would change our approach. You might have a Government who are committed to human rights and committed to transparency and want to try to make progress on the millennium development goals but have weak public financial management systems. We do not say that we will not fund that Government because of that. We will say, "What can we do to strengthen their public financial management systems in order that we can put resources through them?" In the interim, while we are waiting to be able to strengthen those systems, how can we help them in their objectives in, say, achieving progress in education and health et cetera? We would take those partnership criteria and those are the criteria on which we base all our investment decisions.

Q199 Lord Lawson of Blaby: So even if they are outrageously corrupt, as some of them are, you do not say, "Well, we are not going to give money to this country." You say, "Let us teach them how to be less corrupt."

Sue Wardell: No, that is not what I said. If a Government are outrageously corrupt—it is not that they have weak public financial systems that they are interested in developing but they are a corrupt Government who have no interest in improving their financial management systems or transparency—we would not give aid to that Government. That does not mean that we would not give aid to that country, because there are other mechanisms by which we might provide assistance. In Burma, for example, we give no aid to the Government at all but we work through the United Nations and international NGOs and local civil society groups to provide aid and try to support the development of people in Burma because they are some of the poorest people in the world.

Q200 Lord Lawson of Blaby: Of course, where Governments are corrupt, the corruption seldom ends with the Government. The corruption goes right through the society, regrettably. Just focusing on the Governments—forgive me if I have asked this before—could you give us a list of those countries, in addition to Burma, where we refused to provide any aid to the Government because of corruption?

Sue Wardell: You asked us to give you a memorandum on that and we will do that.

Lord Lawson of Blaby: Thank you.

Q201 The Chairman: Lord Lawson referred earlier to Michela Wrong, who in her written evidence to us raised the spectre of an "African Spring", a situation in which fragile states that had previously been heavily supported by the UK and other western donors use their revamped internal security systems to suppress political opposition. How do you respond to that risk? How does the Conflict Pool assess such risks when you are engaging in helping fragile states?

Conrad Bailey: We certainly see it as inevitable that when you are working with conflict issues in these sorts of states you will come into some of these very difficult, extremely finely balanced judgments around whether to engage in this particular issue from a human rights perspective. Will you do more harm by engaging or by not engaging? It can be a very fine balance, particularly if you take one of our principles that came out of the Building Stability Overseas Strategy and one of the things that the World Development Report makes clear, which is that you really do need to develop the security and justice institutions within countries if you are going to help them to avoid conflict or turn them around from being a conflict state. Part of developing their capacity is trying to link them up more with their people and making sure that people feel that the security and justice institutions are there to serve them rather than the state. We have some good examples in the Conflict Pool where we have successfully done that. Sierra Leone is a very good example where, through a combination of different engagement by MoD on the military side and DFID programmes to develop policing, we have managed to bring that effectively together and produce more robust and more engaged security and justice institutions.

The process that we follow is really the same for all projects. First, we do a human rights assessment for a particular bid to look at what the risks are and what the mitigations may be. The mitigation may be that we get UK military personnel or police to engage in a particular training model and we ensure that there is a human rights element in it or something like that. Having identified what the risks may be, we then obviously consult with human rights experts within our departments and the lawyers to assess the risks further. In many cases, there will still be a fine judgment. In those cases, the issues are generally put to Ministers so that they can have full visibility and take a decision on the relative merits of doing things or choosing not to.

An example of where we took a decision to cease doing something was in Ethiopia following the 2007 elections, where we had been conducting a programme of training with the police. The police were involved in various elements of repression during the election and the aftermath. As a consequence, we decided to cease our programme there. The other thing that we do, which is perhaps stepping back at this stage, is that we focus more and more on where we can do early warning and spot where the risks may be evolving so that we can engage early and put in some of these support programmes to develop the human rights awareness within the police or judiciary. We can try to prevent situations from emerging. That is clearly a difficult challenge.

Q202 Lord Hollick: In his submission to us, John Nelson, who is the director of Africa Delivers, made the allegation that aid can actually promote conflict. He cites the example of the Ethiopian Government using aid to clear dissent from the Ogaden region. As part of the work of the Conflict Pool, do you look at examples of where aid can be misused to create conflict?

Sue Wardell: If I can just talk from the DFID perspective on this, one of the key principles of putting in aid is to ensure that we do not do harm. Aid can actually fuel or exacerbate conflict—for example, if it goes to the wrong people, if it benefits one group compared with another or if it does not really address grievances. We know that that is the case and we have examples in the past, such as in our programme in Nepal in 2002. We looked at it through a conflict lens and realised that our aid at that point was benefiting one group—the elite—more than the ordinary people and that it was not getting to the poorest and most disadvantaged. It was playing potentially into the hands of the Maoists in the conflict there. We have developed a strategic conflict assessment tool so that all aid—and that includes aid that will go through the Conflict Pool—is looked at through this tool to see whether it is likely to fuel conflict or make the situation worse. We committed in the Building Stability Overseas Strategy to review this tool in the light of best practice, which is going on, and to ensure that the tool is useful not just for DFID but for the Foreign Office and the Ministry of Defence in terms of their investments and activities. That is ongoing.

Q203 Lord Hollick: So if Mr Nelson is correct in his assertion that aid is promoting conflict in the Ogaden region, would you then recommend that the aid be discontinued?

Sue Wardell: I am afraid that I am not an Africa specialist, so I do not know about that particular region or claim. I could not comment on that. But it is right that aid can be part of the problem if it is not used in the right way, which is why we use conflict assessment to make sure that that is not happening.

Q204 Lord Hollick: Are there examples of where aid has in fact been cut off because it is promoting conflict?

Sue Wardell: The example that I gave in Nepal is where we redesigned our programme as a result of taking it through that conflict assessment to ensure that it was more conflict-proof. That is a specific example, but if you would like us to look at that particular case and get back to you, we can.

Q205 The Chairman: It would be helpful to have a note on that particular case but also on other cases where aid has been cut off. That would be helpful. I will ask you the last question, in case we are cut off by a vote. As you know, in the current climate of considerable government restraint and cutbacks, there is public pressure and pressure that comes on politicians about the level and so on of the aid programme and the commitment that has been given to the aid programme. I am sure that, in particular, there is some concern about aid given in high-risk situations and to fragile states. Because these pressures will come, do you feel that you do enough to justify publicly the successes and the reasons for this particular concentration?

Sue Wardell: Our Secretary of State and the Prime Minister have put a lot of emphasis on communicating much more transparently what we are doing in relation to aid. We recognise that we have a significant burden of responsibility to account for the money that we have been given and how effectively we use it. This is why the Secretary of State asked us to talk about results and be absolutely clear about the results, almost like a social contract—"These are the results that we promised that we would deliver with these resources." It is also why the Secretary of State has committed us to publishing every single project document in terms of investments that we have made so that people can see what investments we have made and what the money is going on. It is also why he has set up the Independent Commission for Aid Impact, which will do evaluations of our aid completely independently of the department and put those in the public domain. There is a range of initiatives that we are taking to better explain to the public what the resources are going on so that they can really see and track them and see what return they are getting on that investment.

The Chairman: If there are no other questions, let me thank you for coming in front of us this afternoon. It has been a very interesting exercise and perhaps a demonstration of precisely what we were talking about in the last question and the last answer of demonstrating more how much you assess the risk in these particular conflict situations. It would be helpful to have the several notes that you have offered us. We are very grateful. Thank you.

Department for International Development (Conflict Pool)—Supplementary written evidence

At the evidence session on the Conflict Pool on 6 September, I undertook to provide further information to the Economic Affairs Committee.

1. A list of countries which used to receive UK aid, but where programmes have been discontinued because countries have "graduated" to middle-income status.
DFID's Bilateral Aid Review refocused DFID's priority bilateral expenditure on fewer places where we could have the greatest impact. The Secretary of State announced prior to the Review that DFID assistance to **China** and **Russia** would end. The remaining countries were considered in terms of development need, the likely effectiveness of assistance and strategic fit with UK government priorities. Ministers therefore decided that by 2016 DFID should also close its bilateral programmes in 16 countries. Of these eight are categorised by the World Bank as lower middle income (Angola, Cameroon, Indonesia, Iraq, Kosovo, Lesotho, Moldova and Vietnam) and four as upper middle income (Bosnia and Herzegovina, China, Russia and Serbia). The remaining four are Burundi, Cambodia, Gambia and Niger.

2. Examples and case studies of where aid has been effective, both from the Conflict Pool and from DFID programmes in conflict-affected and fragile countries.
Well-designed UK aid can make a real difference in tackling both poverty and the causes of conflict and fragility. Even in fragile and conflict affected states, DFID and Conflict Pool programmes can demonstrate real impacts on the lives of the poorest people.

Nepal Demining Project: The UK's support has been a major factor in Nepal successfully clearing all 53 mine fields from the Nepalese Civil War, which were estimated to have killed over 300 people since 2006. Nepal was declared mine-free on 14 June 2011. This was a key objective of the peace accord signed in November 2006. The UK contributed £3.3m to mine clearance activities through the multi-donor Nepal Peace Trust Fund and UN Peace Fund for Nepal. The Conflict Pool additionally provided over £2m which has enabled the United Nations Mine Action Team to train and provide equipment for the Nepal Army's Explosive Ordnance Disposal Unit and the Nepal Army Mine Action Coordination Centre.

British Military Advisory Training Team (BMATT): BMATT, based in the Czech Republic, has provided support and training for overseas forces participating in UN peace support operations. It has trained over 7800 personnel from 33 countries since 2001, primarily through "train the trainers" courses but also through officer training, operational planning courses, etc. All courses are multinational and based on case studies from peace support operations. Courses cover topics such as Code of Conduct, prevention of sexual exploitation, child protection, human rights in peacekeeping and gender awareness. A 2009 external evaluation by Coffey International found that BMATT has contributed significantly to developing the pool of personnel in partner nations suitable for UN peacekeeping deployment and has exceeded its remit.

Iraq Justice and Forensics Project: A British Forensic Team has worked in Iraq since 2005 providing capacity building support to the Iraqi Police Service, initially as part of a wider programme of support to the Iraqi Ministry of Interior and Police, and since 2008 as a stand-

alone project. The project has helped develop an evidence-based legal system in Iraq, as opposed to a confessional-based one which relied on suspects pleading guilty to offences in order to secure a conviction. Conflict Pool funding worth £4.7m since 2008 has supported the establishment of three operational forensics laboratories in Baghdad, Basra and Erbil, plus a training laboratory in the Baghdad Police College. A small UK team of four staff has drawn together Coalition efforts on forensics and successfully leveraged other donor funding, notably £12.5m from Australia for training and £9m from the US for forensics equipment (at current exchange rates). The project is also providing technical assistance on Iraqi and Kuwaiti mass graves excavations and identification of bodies.
In the **Democratic Republic of Congo**, DFID funding has opened over 1,300 km of major and minor roads since 2006, reducing journey times from days to hours and allowing poor people better access to markets and basic services. Since 2008, our community-led recovery programme has been helping villagers to rehabilitate health posts, classrooms, basic water supplies and local roads and bridges. Communities have built and restored over 1,800 classrooms and 90 km of community roads.

With DFID support, the **Ethiopian Ministry of Health** is leading ambitious plans to reduce the burden of malaria through the village health extension workers.. These workers teach communities about how to prevent and treat malaria. Since 2005, DFID support has enabled more than 1.5 million bed nets to be distributed across the country.

In 2010-11, DFID provided a full set of textbooks to all 250,000 children in low-cost independent schools in **Kenya**, most of which are in urban slums. DFID has also launched a pilot project to adapt schools to better meet the needs of communities in the arid lands, and encourage more children, especially girls, to complete a full course of primary education.

In **Pakistan**, DFID support to the National Maternal, Newborn and Child Health Programme, which is 50% DFID-funded, has helped over 8,700 community midwives to enter 18 months training in 99 community midwifery schools that are also being upgraded with DFID's support. 141 district and sub-district hospitals are now offering comprehensive obstetric care services and a further 267 sub-district hospitals and rural health centres have been strengthened to provide basic emergency obstetric care services.

Through support to Social Fund for Development in **Yemen**, DFID contributed to an overall increase in school enrolment rates by 14% in supported schools from 2006 to 2010. This was particularly focused on girls whose enrolment increased by 27% compared to 6% for boys.

Following the recent Bilateral Aid Review, DFID has set out some of the **results that UK aid will achieve by 2015**, including in fragile states. For example, we will help re-integrate 3,000 former combatants into civilian life in Nepal. In Ethiopia we will increase by 50% the number of women we are providing with improved access to security and justice, whilst in Sierra Leone we will help give 50% of all remote communities access to mediation services. We will help to provide sustainable access to safe drinking water for 800,000 people in Sudan, and in Somalia UK aid will help create 45,000 jobs.

3. A breakdown of the proportion of UK aid which goes through different channels of delivery, ie the range of partners through which aid is channelled, and a similar breakdown of DFID assistance.

Annex A gives details of a) DFID bilateral aid and b) total UK bilateral aid to fragile countries in 2009 by channel of delivery, ie broken down by the principal categories of partners through which aid is delivered. Channel of delivery information for the Conflict Pool is not available for 2009, the year preceding the election of the Coalition Government.
Annex B gives similar details for DFID bilateral aid and total UK bilateral aid in 2010 by channel of delivery. It also includes a breakdown of Conflict Pool aid expenditure in 2010 by channel of delivery.

4. Details of governments to which the UK does not, or is no longer giving aid because of concerns about corruption.
We apply four principles in determining whether and how much UK aid to provide to partner governments:

1. A shared commitment to poverty reduction and the Millennium Development Goals

2. Commitment to human rights and other international obligations;

3. Improving public financial management, promoting good governance and transparency and fighting corruption;

4. Strengthening domestic accountability, answerability and enforceability, and citizen engagement.

The application of these principles leads to different programming approaches in different contexts and informs our choice of aid instruments. In **Nigeria, DRC, Kenya, Sudan, Zimbabwe** and **Burma** we do not channel UK aid directly through Government systems. UK support to the **Palestinian Authority** (PA) is based on a rigorous assessment of the risks of corruption and mismanagement. Our financial assistance is provided through a World Bank trust fund which carries out close monitoring of PA expenditure and encourages financial and budgetary reform. In other contexts, for example Zambia, DFID uses Poverty Reduction Budget Support (when a donor provides funds directly to a partner government's central exchequer in support of their programmes) as one of a range of instruments within its bilateral programme portfolio.

We take a view of recent past and expected future commitment to these principles and place particular emphasis on recent performance. We do benchmark these principles and take a view on what good progress should look like. If progress slips we take a clear view on whether this is still the right context to be providing funding. Adjustments to DFID programmes made as a result of breaches of conditions are published in our Annual Report. Those in our Annual Report for 2010-11 are reproduced in the table below.

Country	Programme	Issue	Consequence
Kyrgyzstan	Public Financial Management Programme	Implementation of the Government's PFM reforms has been delayed by one year as a result of a number of both management and political challenges	Delayed disbursement of 2nd tranche of £1m until next FY. Work will begin 1 year later than expected.

		facing the project.	
Kyrgyzstan	Second Rural Water Supply and Sanitation project	Approval of cost-effective construction standards, weak capacity of the implementing organisation, lack of commitment and leadership in the sector, political instability in the country.	Delay in implementation. DFID contribution of £1m has not been fully spent in FY10/11. Schedule of payments will be fully revised
Malawi	Health SWAP	Concerns about value for money of some health procurements (initially raised by the Procurement Oversight Agent that DFID contracts on behalf of all pool partners). Forensic Audit conducted.	£598,697 funds withheld.
Uganda	Uganda: Joint Budget Support Operation	Inaction against corruption found in official report on CHOGM 2007	£5m withheld and corrective actions reassessed at subsequent PRBS review (Nov 2010). Decision taken not to reinstate £5m as budget support but to reallocate to off budget expenditure.
Uganda	Uganda: Joint Budget Support Operation	Underperformance against performance targets	Disbursement was reduced by £2.8m
Ghana	General Budget Support 2010-2011	Inability to meet 17 out of the 42 PAF Targets and 4 out of 15 PAF Triggers	Reduction of initial performance disbursement amount by 5.33% (from £38 million to £36 million)
Afghanistan	Afghanistan Reconstruction Trust Fund	There is no IMF programme in the country at the moment. Concerns about financial management and accountability.	Delayed £85 million payment that was due in November 2010

5. Examples where aid has been cut off because of concerns it is promoting conflict, or changes made to our programmes as a result of conflict assessments identifying concerns.

We take the risk that development programmes may contribute to or exacerbate conflict extremely seriously. All of our work in fragile and conflict affected states is designed and implemented within the framework of the OECD-DAC's 'principles for good international engagement in fragile states and situations'. These ten principles are intended to ensure that development interventions 'do no harm', and where possible make a positive contribution to peacebuilding. As part of this approach, DFID country offices regularly carry out Strategic Conflict Analyses and other forms of context analysis which provide a rigorous understanding of the drivers of conflict in the countries in which they work. This understanding forms the basis for reviews of the conflict sensitivity of our interventions.

We do not have examples of where aid has been cut off completely because of concerns it is promoting conflict. In circumstances where there are such concerns, we have made significant changes to the way in which aid has been delivered:

In **Nepal**, a conflict sensitivity review in 2002 identified the importance of political, economic and social exclusion, and severe grievances these created, as a driver of conflict. The review noted that UK programme activities at the time tended to reinforce these forms of exclusion, because these were often focused on the most accessible areas and benefited the relatively better off. In response, DFID reviewed its geographical and thematic priorities, as well as its choice of partner organisations, to ensure that it was not exacerbating these existing forms of exclusion and grievance.

A 2008 conflict sensitivity review in **Kenya** noted that UK programmes may have been neglecting, or even undermining, stability and peacebuilding through its major service delivery programmes. Traditional sectoral approaches may overlook critical sources of conflict and tension, such as the marginalisation of young people, rapid urbanisation and informal settlements. As a result, the Drivers of Accountability Programme specifically integrated previously neglected groups such as young people and the media, in order to strengthen the fragile political settlement.

In **Nigeria**, a 2009 review found that the UK's programmes were not directly addressing the 'negative peace' – the underlying political tensions that could cause conflict. It also found that the DFID team lacked dedicated resources and staff to address instability. As a result, in 2010 DFID Nigeria developed a dedicated new programme to work on conflict issues, and created a specialist conflict adviser post in the Nigeria office to help ensure a greater focus on the drivers of conflict in the country.

In **Ethiopia,** there is an ongoing conflict between the Government of Ethiopia and an insurgency group - the Ogadeni National Liberation Front - in the Somali Region. Each year, between 1-2 million people require food assistance. Until 2008, food aid was distributed by Government, but distributions were delayed and there were concerns that aid was being withheld from some communities. In response to lobbying by the international community (including DFID), the system was changed with the World Food Programme assuming primary responsibility for distributions through an innovative hubs and spokes system. DFID provided £7 million to WFP for the hubs and spokes operation in 2009/10.

Department for International Development (Conflict Pool)—Supplementary written evidence

We are aware of claims that humanitarian and development aid has been used for political purposes in the Somali Region (of which the Ogaden is a part) - including claims that humanitarian aid has been held from communities perceived to be allied to the insurgency groups. Our current judgement is that the humanitarian imperative to get assistance to people in dire need outweighs the risk of the potential manipulation or distortion of humanitarian assistance. DFID will thus continue to support humanitarian operations delivered through the World Food Programme and NGO operations, as well as support to basic services delivery in the Region. A new Peace and Development Programme is being designed to scale up development in the Somali region: equitable allocation of resources in all areas of the Region regardless of political affiliation will be a key principle of the programme.

Sue Wardell
Director Conflict, Humanitarian, Security and Middle East
Chair of Building Stability Overseas Board

cc: Conrad Bailey, FCO
Steve McCarthy, MOD

DFID BILATERAL OFFICIAL DEVELOPMENT ASSISTANCE TO FRAGILE COUNTRIES, 2009

Countries in bold are DFID fragile focus countries
All figures in £000s

Channel of Delivery	Public Sector *	NGOS and Civil Society *	International NGOs	Donor Country NGOs	Developing Country-based NGOs	Public-Private Partnerships and Networks	United Nations Agencies, Funds and Commissions	International Monetary Fund	World Bank Group	Regional Development Banks	Other Multilateral Institutions	Other *	TOTAL
Afghanistan	**39176.67**	**2731.16**	**54.36**	**6267.94**	**1523.53**		**22153.4**		**64009.73**				**135916.79**
Angola	176.25			808.79	477.96		1250		50				2763
Bangladesh	**60624.26**	**11217.92**	**253.73**	**9524.18**	**46097.32**		**9670.59**		**20568.43**		**153.35**		**158109.78**
Burma	**11911.53**	**106.74**	**901.89**	**5461.41**	**840.72**		**12102.49**				**1828.89**		**33153.67**
Burundi	2379.44	1286.8	477.88	319.02	2621.56		2222.5	100					9407.2
CAR				46.41			1513.36						1559.77
Cameroon	56.23	228.15		91.04	361.4								736.82
Chad	312.16	2351.77					900						3563.93
Comoros													0
Congo, DR	**10765.34**	**10.89**	**10316.81**	**28483.1**	**236.91**		**78434.94**		**8059.31**		**300.6**	**48.75**	**136656.65**
Congo Rep													0
Cote d'Ivoire													0
Djibouti													0
Eritrea		1500		582.31			2000						4082.31
Ethiopia	**141799.63**	**256.11**	**1946.58**	**249.12**	**56.88**		**46950**		**27072.07**				**218330.39**
Georgia	1706.4	38.44	1050	689			800						4283.84
Guinea				417.42									417.42
Guinea Bissau													0
Haiti	183.67	1914.36	500				1800						4398.03
Iran													0
Iraq	10707.63	4249.46		1230.71			5100					37.69	21325.49
Kenya	**23747.92**	**675.28**	**8152.13**	**4392.19**	**14786.04**		**21207.19**						**72960.75**
Kiribati	22.31												22.31
Lao PDR				163.1			100						263.1
Lebanon				6.32									6.32
Liberia	**4892.02**			**6330.19**	**105.4**		**1250**		**6047.61**	**2148**			**20773.22**
Malawi	**57737.57**	**1892.16**	**28.8**	**2098.74**	**593.83**		**5871**						**68222.1**
Mali													0
Madagascar				80.23			750						830.23
Mauritania													0
Nepal	**38179.15**	**1497.92**	**50**	**1628.36**	**3583.5**		**16999.48**		**2528.65**				**64467.06**
Niger	2718.95			1250.55									3969.5
Nigeria	**92584.84**	**1235.72**	**65**	**4687**	**7566.77**		**5630**	**408.09**	**4521**				**116698.42**
North Korea													0
OPT	**12114.26**	**2098.74**	**330.48**	**3106.67**			**8413.34**		**30000**				**56063.49**
Pakistan	**85009.75**	**5898.41**	**8609.24**	**5462.7**	**2713.4**	**32.5**	**15542.19**		**5552**				**128820.19**
Rwanda	**52562.2**	**122.53**		**225.14**	**181.88**		**3022.44**		**550**				**56664.19**
ST & Principe	298.86												298.86
Sierra Leone	**27871.8**	**46.37**	**30**	**4779.08**	**16.91**		**12388.05**		**4239.83**				**49372.04**
Solomon Is	105.26												105.26
Somalia	**455.27**	**7127.54**	**1100.2**	**4051.12**	**1812.06**		**12144.75**						**26690.94**
Sri Lanka	269.37	1500		1678.76	31.9		3495				2585		9560.03
Sudan	**12286.51**	**8272.82**	**1397.28**	**8577.88**	**762.85**	**203.44**	**129232.17**		**25060.75**		**10.18**		**185803.88**
Tajikistan	**631.86**		**60.72**		**54.37**		**1370.44**		**785.15**				**2902.54**
Timor-Leste				49.68									49.68
Togo													0
Uganda	**47851.26**	**86.51**	**46.25**	**1793.67**	**11830.34**		**3513.9**		**1377.19**				**66499.12**
Uzbekistan													0
Yemen	**17403.28**	**1000**	**38.44**	**150**			**1755.07**		**2075.1**		**200**		**22621.89**
Zimbabwe	**19472.79**	**1820.88**	**5557.64**	**3652.59**	**73.78**		**34464.43**		**573.85**		**1927.28**	**14.95**	**67558.19**
TOTAL	**776014.44**	**59166.68**	**40967.43**	**108334.42**	**96329.31**	**235.94**	**462046.73**	**508.09**	**203070.67**	**2148**	**7005.3**	**101.39**	**1755928.4**

*** Notes**

Public Sector - includes activities managed by Donor, Recipient or Third Country (delegated cooperation) Governments
NGOs - includes foundations, cooperative societies, trade unions and ad hoc entities set up to collect funds for a specific purpose. NGO umbrella organisations and networks are also included
Other - includes "for profit" institutations, consultants and consultancy firms, universities, colleges and other teaching institutions, research instututes, think tanks, etc

CONFLICT POOL OFFICIAL DEVELOPMENT ASSISTANCE BY CHANNEL OF DELIVERY, 2010

All figures in £s

Channel of Delivery	Public Sector Institutions			Donor Government			Recipient Government			NGOs and Civil Society			International NGOs			Donor Country NGOs			Developing Country-Based NGOs		
	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD
SOUTH ASIA																					
AFGHANISTAN		53000477	107192								13086217										
SRI LANKA											911214			997128							
NEPAL						33585		134000		279160			343883	438129							
INDIA											20970						99852			77698	
PAKISTAN											5970			378048			8550			489724	
REGIONAL					119831												275195			98976	
SUBTOTAL	0	53000477	107192	0	119831	33585	0	134000	0	279160	14024371	0	343883	1813305	0	0	383597	0	0	666398	0
STRATEGIC SUPPORT FOR INTERNATIONAL ORGANISATIONS														381360							
MIDDLE EAST AND NORTH AFRICA																					
JERUSALEM																					
TEL AVIV																					
LEBANON																					
YEMEN														216316							
IRAQ				68630	470255									50950							
WEST BANK AND GAZA					237849									67376			257803			342242	
SUBTOTAL	0	0	0	68630	708104	0	0	0	0	0	0	0	0	334642	0	0	257803	0	0	342242	0
AFRICA																					
SUDAN							6248875	50605													
SOMALIA							60398	173858													
DRC							487720	887391													
KENYA							1711147	100286													
SIERRA LEONE							661096														
GHANA							40000	68529	1249900												
ZIMBABWE								2838265													
LIBERIA																					
ETHIOPIA								14971	156000												
RWANDA									50000												
SOUTH AFRICA																					
BOTSWANA									7605												
GUINEA BISSAU																					
GUINEA																					
NIGERIA									36500												
REGIONAL							6000														
SUBTOTAL	0	0	0	0	0	0	9215236	4133905	1500005	0	0	0	0	0	0	0	0	0	0	0	0
WIDER EUROPE																					
ASIA REGIONAL (INCL CAUCASUS/CENTRAL ASIA)					151876									727554			166120				
GEORGIA						54922								361426			30037				
MOLDOVA						8132															
KOSOVO	1999978				2791832						538791										
BOSNIA					577406	85050		73464				338775			149771						
SERBIA						17000					419147										
UKRAINE						9376								26047							
MACEDONIA																					
AZERBAIJAN						2517											13120				
ARMENIA						22249															
TAJIKISTAN														33000							
KYRGYZSTAN																	36370				
REGIONAL					90799																
SUBTOTAL	1999978	0	0	0	3611913	199246	0	73464	0	0	957938	338775	0	1148027	149771	0	245647	0	0	0	0
TOTAL	1999978	53000477	107192	68630	4439848	232831	9215236	4341369	1500005	279160	14982309	338775	343883	3677334	149771	0	887047	0	0	1008640	0

All figures in £s

Channel of Delivery	Public-Private Partnerships and Networks			Multilateral Organisations			UN Agencies, Funds and Commissions			European Union Institutions			Other Multilateral Institutions			Other			
	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	DFID	FCO	MOD	TOTALS
SOUTH ASIA																			
AFGHANISTAN																			66193886
SRI LANKA																			1908342
NEPAL									256792									909	863415
INDIA																			198520
PAKISTAN																	74015		956307
REGIONAL																	20622		514624
SUBTOTAL	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**256792**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**94637**	**909**	**71258136**
STRATEGIC SUPPORT FOR INTERNATIONAL ORGANISATIONS							**620000**	**1340164**			**122760**					**428686**		**553000**	**3445970**
MIDDLE EAST AND NORTH AFRICA																			0
JERUSALEM																			0
TEL AVIV																			0
LEBANON																	1305441		1305441
YEMEN																	132521		348837
IRAQ							300044	1325238									2087148		3933591
WEST BANK AND GAZA			1549715														149545		2604530
SUBTOTAL	**0**	**0**	**1549715**	**0**	**0**	**0**	**300044**	**1325238**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**3674655**	**0**	**8561073**
AFRICA																			
SUDAN								500000											550605
SOMALIA																			173858
DRC																			887391
KENYA							100000	300000											400286
SIERRA LEONE								1700000											1700000
GHANA																			1318429
ZIMBABWE																			2838265
LIBERIA																			0
ETHIOPIA																			170971
RWANDA																			50000
SOUTH AFRICA																			0
BOTSWANA																			7605
GUINEA BISSAU								37000											37000
GUINEA																			0
NIGERIA																			36500
REGIONAL													316000	1568283	250000				1818283
SUBTOTAL	**0**	**0**	**0**	**0**	**0**	**0**	**100000**	**2537000**	**0**	**0**	**0**	**0**	**316000**	**1568283**	**250000**	**0**	**0**	**0**	**19620429**
WIDER EUROPE																			0
ASIA REGIONAL (INCL CAUCASUS/CE											63617			65061			40118		1214346
GEORGIA											1173707						62011		1682103
MOLDOVA											46104			56904			11865		123005
KOSOVO																			3330623
BOSNIA																			1224466
SERBIA					90068														526215
UKRAINE																			35423
MACEDONIA																			0
AZERBAIJAN																			15637
ARMENIA																			22249
TAJIKISTAN																			33000
KYRGYZSTAN														78412					114782
REGIONAL																			90799
SUBTOTAL	**0**	**0**	**0**	**0**	**90068**	**0**	**0**	**0**	**0**	**0**	**1283428**	**0**	**0**	**200377**	**0**	**0**	**113994**	**0**	**10412626**
TOTAL	**0**	**0**	**1549715**	**0**	**90068**	**0**	**1020044**	**5202402**	**256792**	**0**	**1406188**	**0**	**316000**	**1768660**	**250000**	**428686**	**3883286**	**553909**	**113298234**

Economic Affairs Division, Government of Pakistan—Written evidence

OVERVIEW OF DFID ASSISTANCE TO PAKISTAN

On May 31, 2011, Andrew Mitchell, UK Secretary of State for International Development, committed £1.4 billion of assistance to Pakistan, for the period 2011-12 to 2014-15. Pakistan would become the largest recipient of bilateral aid from the UK. The UK's budgetary support for poverty reduction and its special focus on health and education makes it one of Pakistan's most important partners in fighting poverty and promoting social sector development.

DETAILED RESPONSES TO THE QUESTIONS POSED BY THE HOUSE OF LORDS

1(a). How far and in what way does ODA affect the economic growth of recipient countries?

ODA contributes towards fostering broad-based development and complements the national development initiatives in the recipient countries. Pakistan, like other capital-scarce nations, conspicuously relies on foreign aid to finance savings-investment gap and trade gap. ODA also helps to realise the national development strategies and meet the capacity gaps in effective public service delivery.

The question of impact of ODA on economic growth is inconclusive in economic literature as it had positive, non-existent, or negative impact[237] on growth in statistical terms.

1(b). Where possible to identify, what has been the impact of British ODA?

There is no empirical study showing the long run effect of British assistance, specifically, on economic growth in Pakistan. The short-run analysis, however, shows that British ODA, by and large, helped Pakistan in a number of areas. In the Education sector, DFID:

- Recruited 34,000 teachers
- Provided stipends to 680,000 girls
- Distributed 39.8 million free textbooks
- Supported the exam system.

In Health, DFID:

- Prevented 340,000 children and 19,000 mothers dying since 2003
- Reduced the number of babies dying at birth from 82 to 69 children per 1,000 since 2001
- Nearly halved the number of women dying in childbirth from 533 to 276 women per 100,000 births since 1999
- Helped fund 22,000 lady health workers
- Trained community midwives in the areas bordering Afghanistan.

[237] See Boone, 1996: Bumside and Dollar, 2000, Mansen and Tarp (2000a, 2000b), Kosack (2003), McGillavary (2004) etc.

British ODA has also:

- Helped facilitate 1.5 million microfinance loans
- Helped set up the largest branchless banking system in Pakistan
- Provided capacity-building grants to eight microfinance institutions
- Provided legal aid to 6,000 women victims of violence
- Empowered 1.26 million citizens to implement 14,000 projects
- Helped the Government of the Khyber Pakhtunkhwa change its financial budget from one- to three-year cycles.

1(c). How robust are results from studies in this area?

The empirical evidence discussing the impact or ODA on growth or social indicators in Pakistan are limited. Firstly, Ishfaq (2004)[238] found a statistically insignificant effect of aid on GDP growth, per se, but found gains in Poverty reduction in Pakistan. Another study[239] found relatively stronger evidence for aid's effect on a set of broader indicators of economic wellbeing. The results from the second statistical study are more robust as the author used a different type of regression model from the earlier one – an autoregressive distributed lag model – which helps explain why the author finds a more significant effect of aid on growth. This technique asks, for each year, how much is GDP predicted solely by GDP in the past, or, in fact, how much is predicted by changes in ODA? This, thus, may present a more robust estimation of aid's impact, and provides good evidence that aid can have significant, positive effects in Pakistan. Finally, Nasim et al[240] also established a significantly positive impact of ODA on Human Development Index in Pakistan.

2. How does economic growth in countries which experience large surges in ODA compare to similar countries which do not?

ODA may lead to self-reliance rather than dependence in the countries which experience large surges. Pakistan has experienced a surge of aid since 2000 – and the benefits are quite evident. According to the World Bank indicators, following a decade of anaemic economic growth, Pakistan's economy has grown by more than 6.5 percent per year since 2003. Poverty has also declined significantly. Exports have grown by more than 15% since 2004, and investment as a share of GDP increased from 17% in 2001-02 to 20% in 2005-06.[241]

During this period, a substantial contribution towards the ascendant course of economy is owed to a series of structural reforms in Pakistan including regulatory reforms, financial sector reforms, privatization, tax reforms, tariff reforms etc.

3. What lessons, if any, can be learnt from the experience for former aid-receiving countries which have graduated from reliance on ODA?

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[238] Ishfaq, Muhammad (2008), "Aid Effectiveness, Debt Capacity and Debt Management in the economy of Pakistan", PhD dissertation, Quid-a-Azam University, Islamabad
[239] Ali, Muhammad (2008), "Aid Effectiveness on the Social Landscape of Pakistan", M.Phil dissertation, International Islamic University, Islamabad
[240] Nasim and Ali (2009), "Effectiveness of Foreign Aid and Human Development", The Pakistan Development Review, 48:4 Part II (Winter 2009) pp 853-862
[241] The World Bank, "Growth in Pakistan", http://go.worldbank.org/QTEHWN5Q7, accessed 13 June, 2011

Foreign assistance in the countries that graduated from reliance from ODA was supplemented by a series of structural reforms. This, in turn, created an enabling environment and diversified foreign inflows such as FDI and capital market etc. For instance, India, Philippines and South Korea introduced reforms in financial sector, budgeting, and regulatory framework which increased their savings and trade and did away with their reliance on ODA.

4(a). What factors determine the effectiveness of ODA in recipient countries?

Aid is most effective when it:

- Is channeled through national systems
- Is aligned with national priorities
- Is concessional in nature – i.e. grant-based
- Focuses on technical cooperation
- Is untied at source
- Is predictable and reduces fragmentation and proliferation
- Ensures mutual accountability with results-driven and continually measured interventions
- Does not undermine public sector institutions
- Does not substitute the domestic effort but ensures self-reliance

4(b). Are they dependent on the scale and form of aid flows?

The effectiveness of ODA depends on both its scale and form. During 1980-2000, there was a shift from project and programme based loans to policy based support. These Development Policy Loans call for certain preconditions and are usually constrained by macroeconomic policies of recipient countries. After 2000, the focus of aid paradigm is on budget support and increased ownership of recipient countries. Under this third paradigm of aid, it is best scaled to needs and priorities through:

- Multi-year commitments
- Demand-driven disbursements
- Sector-wide and programme-based approaches.

It is also preferred in concessional form, including:

- Untied obligations.
- Grants rather than loans. In certain cases, however, grants substitute the domestic evidence instead of supplementing them. As a result, dependency takes in and country loses self-sufficiency e.g. Pakistan lost wheat sufficiency in case of PL480 grant.

4(c). How is aid effectiveness monitored?

ODA is monitored through result-based system, mutual accountability frameworks, periodical monitoring by implementing agencies, impact assessment studies and platforms for review of aid effectiveness. In this regard Pakistan has established:

- A draft Common Results Framework
- Development Partner Scorecards
- The Development Assistance Database (DAD)
- Technical Working Group on M&E
- Portfolio review meetings at the bilateral level with all donors
- A D-10 Forum, comprising lead donors including the UK
- Participation in final round of Paris Declaration Survey 2011

5(a). Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA?

Conditionality does help in propelling conditions to introduce a corrective policy action provided that it gives due consideration to the political limitations. In the case of Pakistan, for instance, government is being asked to eliminate subsidies and rationalise tariffs. This, no doubt, is theoretically consistent but not compatible with the political and social conditions of Pakistan. Unilateral or excessive conditions and ownership are mutually exclusive in the context of aid effectiveness.

5(b). What has been the British government's experience?

The British government's assistance to Pakistan has been predominantly grant-based, with relatively little conditionality.

6(a). How should ODA be allocated?

The allocation of ODA should be more developmental and less political. More specifically, the allocation should consider the social indicators, policy environment and economic shocks of the recipient countries. Not only this, the priority should be accorded to areas with high levels of headcount poverty, low income per capita and good policy environment to make the allocation poverty-efficient. Governments should neither be bypassed nor bullied while allocating aid.

Although ODA allocation is motivated by altruistic as well as the selfish donor motives yet donors are embracing selectivity. In case of Pakistan, the national priorities as outlined in the Framework for Economic Growth, Poverty reduction strategies, and the forthcoming Foreign Assistance Policy should be given due consideration.

6(b). How far do (and should) the Millennium Development Goals (MDGs) shape aid allocations?

The MDGs have substantially reshaped aid allocations during the last decade, as the focus of aid has shifted from 'growth' to 'development'. The recent literature on ODA focuses on a broad set of social indicators, like poverty, universal education, gender equality, child and maternal health and HIV Aid prevalence, etc. Such MGD-based measures now drive aid planning and monitoring in Pakistan.

7(a). How useful is the UN target of rich countries giving 0.7% of GNP in ODA?

If rich countries disburse 0.7% of GNP by 2015, the world could make major strides toward achieving the MDGs and ending extreme poverty within one generation. The effect of ODA on economic growth apart, the literature corroborates that ODA has a significantly positive effect on social indicators – e.g. life expectancy and literacy (Ali 2008) in Pakistan. So the commitment of 0.7% could have far-reaching effects with regard to achieving the Millennium Development Goals.

7(b). If the target was reached would it lead to more official aid than developing countries could efficiently absorb?

If the target was reached, there would have been an increase in the aid flows but the absorption depends on how and where the money is being spent. In this regard a host of factors such as geographic priorities, the balance between main areas for intervention, bilateral and multilateral channels and the set of delivery instruments is required. Pakistan's absorption of increased aid will rely on spending being directed where:

- Public sector funding is lacking
- Social indicators are at the lowest ebb
- Insufficient number of donors is operating in the sector or geographic area.

If funds are fungible, then some resources are freed up for the Government which can be redirected to higher priority areas.

8. Does ODA complement or inhibit private investment in developing countries?

The effect of ODA on private investment is the source of ongoing debate, and no empirical study has addressed this in Pakistan. Evidence indicates, however, that aid, especially when wasteful or counterproductive, can hinder investment by contributing to 'Dutch Disease'(Inflating prices and thus reducing export competitiveness) and leading to crowding out of private investment by public investment.

Aid, thus, is most effective in *complementing* private investment (and thereby contributing to economic growth) when it helps lower the costs of investment, reduce risk, improve competition, and enhance human and institutional capacity. These priorities are at the centre of Pakistan's new Framework for Economic Growth, and thus future aid ought to be aligned with the crucial initiatives.

9. How does ODA, and British aid in particular, interact with financial flows from other sources including new donors, such as China, India and Brazil, private capital flows, and the philanthropic sources?

DFID is both one of the largest contributors of aid, as well as a leader among donors in enacting the recommendations of the Paris Declaration and Accra Agenda, and in partnering with the Government of Pakistan to ensure the optimal effectiveness of development assistance.

10. How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

Evidence suggests that aid programmes targeted at achieving security rather than promoting development are often ineffective. However, aid can be markedly effective at reducing poverty and saving lives in insecure areas, when it takes a development-orientated approach, and when it is properly planned, implemented, and overseen. The experience in Pakistan has been that aid projects in insecure areas *have* been able to improve well-being and livelihoods, but these should remain distinct from any military or non-military efforts to establish security in these areas.[242]

The combination of development and security objectives is often prompted by underlying assumption that poverty fuels insecurity – but this is not so clearly the case. The poorest areas of Pakistan i.e. rural Sindh, southern Punjab and most of rural Balochistan do not have security concerns at all. To ensure aid effectiveness, development ought to be pursued in its own right, not as a means to improve security.

11. What are the prospects for using aid to support market-based initiatives, for example in providing insurance against earthquake damage?

The prospects for market-based initiatives in Pakistan are good, though at present undeveloped. Earthquake insurance programmes, as tried in China[243] and Turkey[244], could have significant benefits in the earthquake-prone regions of Pakistan, though, to date, no major development projects have entailed such initiatives on a large scale.

12. In what ways, if any, can the British government improve the effectiveness of its development aid?

British Government has a comparative advantage in MDG-based areas like pro-poor growth, education, health and gender equality. DIFD can play effective role towards realising the concept of lead donor in these areas to strengthen delegated cooperation in developing countries, especially in Pakistan.

Moreover, DFID has expertise in Result Based Frameworks and may strengthen the monitoring and evaluation systems in partner countries. Since DFID has a stronger focus on aid impact, so it has a vital role in developing appropriate performance measurement tools.

DFID continues to be an exemplar among donors for a forward-thinking approach to aid. In last year's Partnership Talks, the governments of the UK and Pakistan were in close collaboration on many critical development issues. Pakistan continues to encourage donors to fully utilise the Development Assistance Database and Common Result Framework to help track and map out all development cooperation data, as well as to coordinate proactively with other donor partners to harmonise approaches.

Muhammad Asif
Joint Secretary (UN/PC), Economic Affairs Division, Government of Pakistan

29 June 2011

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242 Andrew Wilder (2009). "Testimony on US aid to Pakistan to US House Committee on Oversight and Government Reform," Feinstein International Center, Tutta University. Dec. 9, 2009.
243 Zifa Wang, Tun Lin, and George Walker (2009), "Earthquake Risk and Earthquake Catastrophe Insurance for the People's Republic of China (No. 7)." Asian Development Bank Sustainable Development Working Paper Series, June 2009.
244 Solamot Yazici (2003), "The Turkish Catastrophe Insurance Pool (TCIP) and the Compulsory Earthquake Insurance Scheme," presented at the World Bank Disaster Management Course, Istanbul, Turkey, Apr.-May. 2003.

Foreign and Commonwealth Office; Department for International Development; and the Ministry of Defence—Written evidence

Submission to be found under Department for International Development; Foreign and Commonwealth Office; and the Ministry of Defence—Written evidence

Independent Commission for Aid Impact—Supplementary written evidence

I am writing following the hearing on 17 January at which I gave evidence to your Committee for your inquiry into the Economic Impact and Effectiveness of Development Aid. During the hearing I promised to provide a note with further information to the Committee on a number of questions asked.

As I mentioned in the hearing, the Independent Commission for Aid Impact (ICAI) was launched in May 2011. Our role is to publish reports specific areas of the aid programme as published in our work plan. As Chief Commissioner, I am obliged to restrict my comments to the body of work that we have published and to the evidence that we have gathered during the course of our work.

ICAI's Resources

Q53 - Lord Levene of Portsoken: How many people during the year work in producing your reports?

ICAI has been in operation for eight months. Prior to our launch, DFID took the decision to establish ICAI as a small and efficient body, with a contracted-out service provider who would undertake the preparation of reports on its behalf.

The consortium which won the contract comprises four separate organisations (KPMG, Agulhas Applied Knowledge, SIPU International and CEGA). A core team of four people manages the consortium's day-to-day work. They in turn call on staff from across the four organisations (including personnel from across KPMG's global operations – over 140,000 employees in over 140 countries), as well as from a much wider pool of independent consultants and experts, to deliver each report. This arrangement provides access to an extremely wide range of people with varying technical, geographical and sectoral experience and means that ICAI does not have to fund a large, permanent pool of staff.

Teams for each report typically range between 5 and 12 people, depending on the size and scope of the report. To give a sense of the scale of effort required for each report, the following is a list of the number of person days involved in delivering each of our first four reports.

- Effectiveness and VFM: 99.25 days
- Anti-Corruption: 287.25 days
- Bangladesh: 144 days
- Zimbabwe: 161.5 days

ICAI's Budget

Q533 - Lord Lawson of Blaby: Perhaps you could include in the note the cost.

ICAI's budget is made up of two elements: the cost of the Commission itself and the payment to the contractors undertaking the evaluation work.

In 2011/12, the cost of the Commission will be £409,000. This budget is currently allocated as follows:

Cost of the 4 Commissioners	£101,500
Cost of the Secretariat	£280,200
Other costs, including office accommodation	£27,300

The payment to the contractors will depend on the amount and nature of work commissioned from the contractors by ICAI. The total cost of this contract between May - December 2011 was £545,410. More detailed information on ICAI costs can be found on DFID's published database (http://projects.dfid.gov.uk/).

The total value of the contract was classified by DFID and is not in the public domain. DFID's advice, with which we agree, is that this will avoid the contractor simply bidding up to the declared value of the contract. At the end of each year of operations, however, we will publish full details of all expenditure, including payments for all work undertaken by the contractor.

Recovered losses

Q581- Lord Shipley: Could we have a breakdown of the £1.1 million, where it is and what it is?

The table below sets out evidence that DFID has previously provided to the House of Commons Committee of Public Accounts, showing a breakdown of fraud losses from financial years 2009-10 and 2010-11. The £1.1 million figure relates to *Gross Loss* from 2010-11 in the table. The figures vary slightly from those in our report because of the re-classification of some cases.

LOSSES AND RECOVERIES IN DFID'S BILATERAL AID PROGRAMME 2009–10 AND 2010–11—ANALYSED BY COUNTRY

	2009–10		2010–11	
	Gross Loss £	*Fraud Recovery* £	*Gross Loss* £	*Fraud Recovery* £
Afghanistan	167,870	167,870		
Balkans (includes Bosnai, Serbia, Kosovo)	4,021	4,021		
Bangladesh	9,135	6,045		
Burundi				
Caribbean				
Central Asia, South Caucasus, Moldova				
China			14,383	14,383
Democratic Republic of the Congo	231,248	1,257	2,018	-
Ethiopia			278	278
Ghana	3,322	3,322	44,529	13,000
India			252,317	252,317
Indonesia			44,323	44,323
Kenya			101	89
Liberia				
Malawi	3,000	—	658,434	619,409
Montserrat			1,461	-
Mozambique				
Nepal				
Nigeria			1,494	1,494
Overseas Territories				
Pakistan	668	668	7,969	7,969
Palestinian Authority				
Rwanda	37,746	13,720		
Sierra Leone			116,471	116,471
Somalia	270	—		
South Africa			1,300	1,300
Southern Africa Regional (inc Lesotho, Angola)				
Sudan				
Tanzania	295	—	310	310
Uganda			12,700	-
Vietnam				
Yemen				
Zambia			1,793	-
Zimbabwe				
Grand Total	**457,575**	**196,903**	**1,159,881**	**1,071,343**

1. The figures in the table above do not include a £1.5 million loss in Kenya, which was DFID's share of the losses to fraud and other abuse in the Kenya Sector Support, Programme, as this loss was not confirmed until 2011 with the finalisation of the Government of Kenya's investigation. We expect to recover the whole of this amount.

DFID Admin Budget

Q584 - Lord Lawson of Blaby: It would be useful to know the breakdown and what the change over time is in the administrative budget between staff on the ground, as you call it, and staff here in London, assuming that that is what you are talking about.

ICAI does not hold this information.

Q585 - Lord Lawson of Blaby: Finally on this point, are you aware of how much of their administrative budget is being devoted to trying to monitor and eliminate corruption?

ICAI does not hold this information.

Please do not hesitate to contact me if you require any further information.

Mr Graham Ward
Chief Commissioner

23 January 2012

Institute of Economic Affairs—Written evidence

Consultation submission – The Economic Impact and Effectiveness of Development Aid

By Prof Philip Booth, June 2011

DISCLAIMER: As part of its educational objectives the IEA facilitates responses to public policy consultations by academics and others. However, the views expressed, whilst generally consistent with the IEA's mission, are those of the authors and not those of the IEA (which has no corporate view), its managing Trustees, senior staff or Academic Advisory Council. If these views are quoted then we ask they are quoted as the views of the author(s)

Question one

1. The evidence suggests that there is no relationship between ODA and economic growth. This is not surprising given that prior theory suggests that much damage can come from ODA. Some of this damage is micro-economic and therefore not so serious but other aspects of the damage that aid can cause relate to the political infrastructure. If aid encourages bad governance, then it is likely not just to inhibit economic growth a little but to seriously impair a country's development. The situation was put neatly by Bauer who suggested that, if aid has the benefits its proponents claim, then those benefits will be very slight. However, if aid has the problems its opponents claim, those problems will be very great. In other words, the risks of foreign aid are huge. At best, it is true to say that there is no evidence that aid promotes development. In the paragraphs below the theoretical and empirical arguments are explained in more detail.

2. The provision of government-provided development aid is, by nature, a top-down process. At a fundamental level, therefore, aid rewards the governing elite in those countries where those in power keep their people poor. Aid also makes it more likely that incompetent, corrupt, or brutal government will survive because aid provides the resources for the elite to alleviate some of the internal problems caused by poor or unjust government. Frequently, such governments have pursued policies that involve the persecution or expulsion of the most productive ethnic groups in society. The availability of aid also provides incentives for governments to pursue policies that will attract more aid—that is, policies that lead to high levels of absolute poverty and policies that promote government consumption and not investment, thus giving the impression that money is not available for investment, health, and education.

3. Aid also changes lines of accountability in government. Governments become accountable to those from whom they receive aid—either other governments or international institutions—and not to their own people. In 2001, Tanzania had to produce 2,400 reports and studies on different aspects of present and future aid. A former minister of finance of Kenya estimated he had to spend 75% of his time in discussions with donors.[245]

4. As Bauer pointed out, development aid leads a country's political and economic structures to orientate themselves inappropriately. In many African countries, aid is a significant

[245] Erixon, "Poverty and Recovery.: The History of Aid and Development in East Africa," *Economic Affairs*, Vol 23, No

proportion of national income.[246] Talented and entrepreneurial people within a country that receives large amounts of aid have a strong incentive to direct their efforts upwards, towards government, to become beneficiaries of aid-financed projects, instead of attempting to raise their material position through business and entrepreneurship. Thus, aid encourages what economists call *rent seeking*, whereby work is directed towards collecting government largesse rather than towards producing goods and services that benefit the human community. This whole process strengthens the hold of government on economic life, which is generally one of the most serious problems in under-developed countries.

5. On a wider scale, the greater the proportion of national income and wealth that is controlled by government, the greater is the incentive for ethnic groups to engage in conflict to try to control government; on the other hand, if freedom of contract, exchange, and private property rights are the main vehicles for transferring and upholding the control of property, fruitful economic activity, rather than political activity and conflict, are more likely to produce increases in income and wealth for individuals and communities.

6. The negative relationship between economic growth and natural resources is now well established: the so-called "natural resource curse."[247] In economic terms, the provision of aid is very much like the existence of natural resources within a country: Aid is an "endowment" which empowers governments and makes it more worthwhile to invest economic resources or even to use military means to control the machinery of government. Aid can therefore nurture bad government, which is the very problem that entrenches poverty in the first place. Studies have found a strongly negative relationship between the receipt of aid and the extent of democracy.[248]

7. There is also a tendency for aid not to be used for its intended purpose, such as health and education, but, instead, to be used to meet the aims of the governing elite (often including personal betterment). This can happen for two reasons. First, aid might be siphoned off before it reaches its intended recipients. A 2004 survey tracked spending by the government of Chad intended for rural hospital projects. Only 1% of the money intended for the projects actually reached the hospitals. It is therefore not surprising that about 40% of Africa's military spending is inadvertently financed by aid.[249]

8. Another problem is that aid is "fungible."[250] The specific aid money directed toward investment in health and education may be used for the intended purposes, in order to provide evidence for donors. However, this aid money displaces investment that otherwise would have taken place in such sectors, including private sector investment. The additional resources are then, in effect, used for government consumption. It is for this reason that we should be skeptical of the use of specific case studies to illustrate the case for aid – we can only see the obvious "first round" effects of aid and not what happens down the line as governments change their spending priorities in response.

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246 In Tanzania and Kenya, for example, it reached 30% of national income in the mid 1990s.

247 See Jeffrey D. Sachs and Adrew M. Warner, "The Curse of Natural Resources," *European Economic Review* 45 (May 2001): 827–838.

248 Simeon Djankov, Jose Garcia-Montalvo, and Marta Reynal-Querol, "Does Foreign Aid Help?," *The Cato Journal* 26 (March 2006): 1–28.

249 Reported in Paul Collier, The Bottom Billion, *Why the Poorest Countries are Failing and What Can be Done About It* (Oxford: Oxford University Press, 2007).

250 See Erixon, *Aid and Development*, 11.

9. Aid can help promote corruption in public life. If development aid receipts are a significant proportion of national income, then the resources available to government are greater. In such situations, government functionaries and ministers have relatively more power and economic resources that can be used for economic preferment. Government officials and politicians are in a position where they control the allocation of substantial economic resources and therefore become more susceptible to corruption, particularly where legal systems are inadequate or are themselves corrupt.[251]

10. These political problems also infect the donor countries. If donor country charities, NGOs, and consultants are the channels of significant amounts of aid funds, they have an incentive to campaign for aid-financed solutions to poverty in under-developed countries. Many charities now receive a significant proportion of their income from the government and are prominent campaigners for more aid. For example, income from government is equal to 30% of private donations to the aid charity Cafod. This of itself is not necessarily a bad thing. Aid money is arguably better spent when it is directed through charities than when it is delivered directly by government bureaucracies. Nevertheless, this is a potentially dangerous situation. The easiest way for an agency to increase its resources may well be by campaigning for increased government aid budgets and through parliamentary lobbying rather than through developing the unconditional charity that individual Catholic supporters provide. Given this, it is worth noting that Cafod's spending on "Education and campaigns" in 2008/09 was about ten times the total annual donations to the Institute of Economic Affairs (IEA), a major UK policy and education think tank covering all areas of economics. Cafod thus devotes substantial resources to campaigning and otherwise promoting the case for increased aid or for government intervention in other respects.

11. A strong economic case for aid rests on two assumptions. The first is that the preconditions for economic development and growth relate to a shortage of savings, problems caused by declining terms of trade, lack of education, and so on, which can be resolved by income transfers from rich to poor countries. The second is that, in practice, aid transfers can be managed by benign governments that can resolve these problems. We have made a prima facie case that these conditions might not hold. What does the empirical work say about aid and development? It is, in fact, hard to find a positive relationship between aid and growth: indeed, there appears to be a negative relationship. It does not follow that a negative relationship between aid and economic growth necessarily implies cause and effect, but it does, at least, call into question unqualified exhortations to increase aid. It also renders problematic any suggestion that support for government aid should be considered a moral imperative.

12. After the late 1970s, aid to Africa grew rapidly, yet GDP growth collapsed and was close to zero or negative for over a decade from 1984.[252] GDP growth in Africa did not start to pick up again until aid fell in the early-to-mid 1990s. In East Asia, South Asia, and the Pacific, one finds a similar trend. As aid was reduced in these regions from the early 1990s, national income increased rapidly. A number of detailed country studies find no benefits from aid whatsoever across a range of periods and a large number of countries. In total, in the 30

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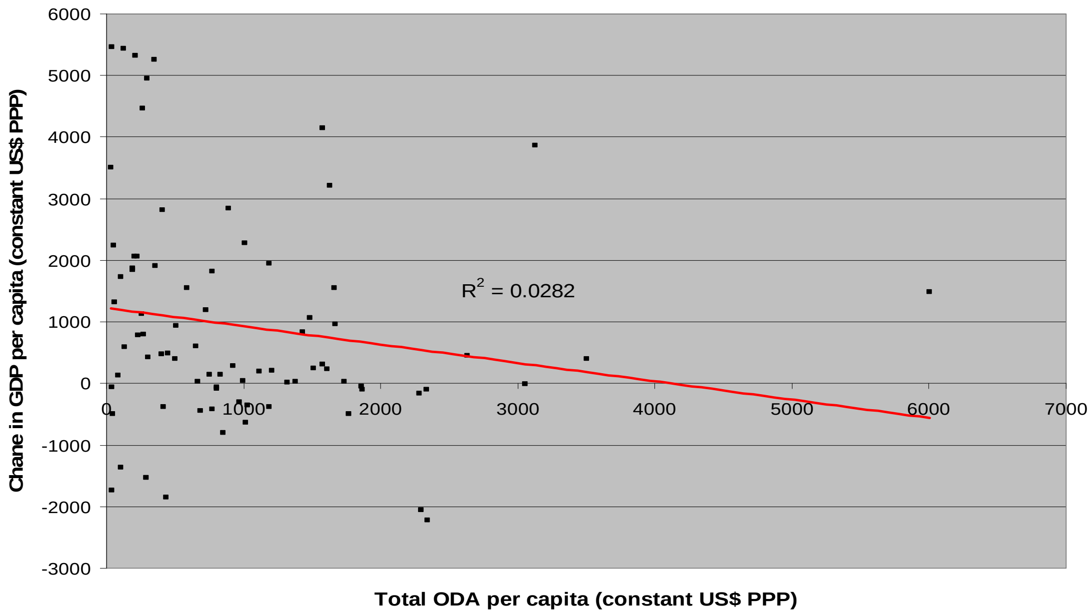
[251] This should not be thought a patronizing remark about the governments of underdeveloped countries (see Ian Senior, *Corruption - The World's Big C* (July 2006). IEA Research Monograph No. 61. Available at: www.iea.org.uk. In any country where government officials have control of vast economic resources and significant discretion, fraud and corruption are likely to result (witness the EU Common Agricultural Policy). However, if countries are already poor because of bad governance, providing development aid can simply feed the system that keeps the country poor.
[252] Erixon, *Aid and Development*.

years after 1970, Africa received $400bn of aid, under different regimes, tied to different forms of economic policy and reform, yet there is no evidence of a single country developing because of aid.[253]

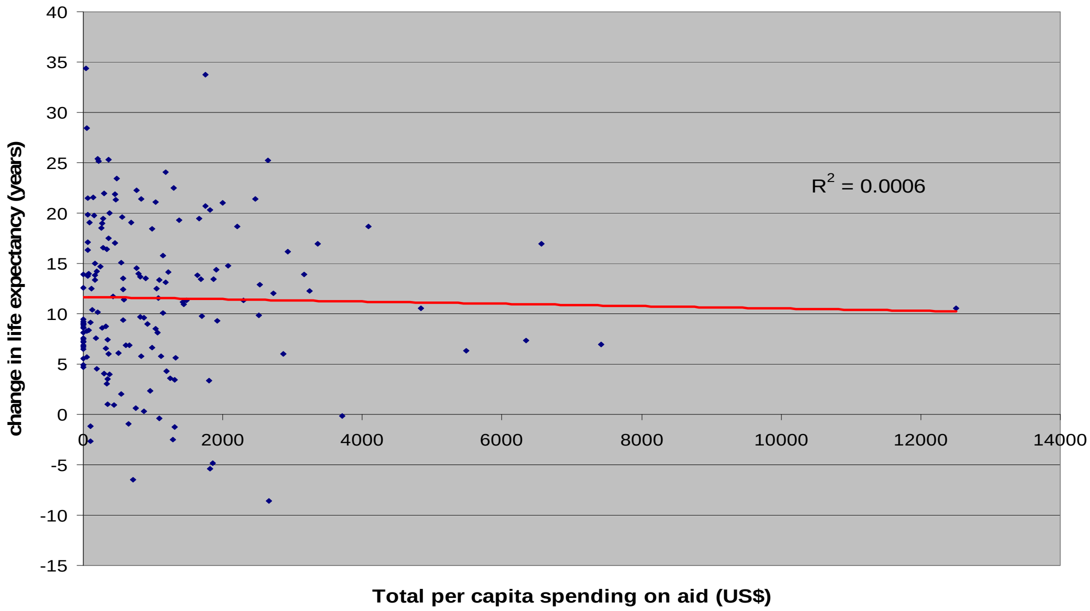
13. If we take 1950 as a starting point, it is clear that many countries that were then poor have become relatively wealthy while others have remained poor. It is impossible to find evidence that aid was an important factor in helping those countries that have become rich. Botswana, for example, increased its income per head thirteen-fold from 1950 to 2001 while much of Africa had a zero or negative growth rate.[254] This progress is almost certainly due to Botswana possessing many of the important features of good governance. Differences in aid do not distinguish Botswana from other African countries. The following two figures show the relationship between aid and economic growth (figure one) and aid and improvements in life expectancy (figure two). It is very clear that there is no statistically significant relationship in either case. This is not because aid tends to be focused on the countries that are growing slowly, as more detailed econometric studies show. The data suggest strongly that aid does not improve either economic growth or important human development indicators such as mortality.

Figure one



253 Ibid.
254 Easterly, "Reliving the '50s."

Figure two



- with thanks to Julian Morris for supplying both figures

14. A final important point stems from the fact that around 40% of the poorest one fifth of countries in 1985 were not in the poorest one fifth of countries in 1950.[255] Thus, while most attention is focused on the challenge of assisting poor countries to develop, it is also the case that nations can experience negative development (at least in relative terms). This suggests that aid is not the crucial factor affecting a nation's economic wellbeing. From these observations, three facts are clear: poor countries can develop without aid; countries that receive aid do not tend to develop; and countries that are relatively rich can become poor again. These phenomena are troubling for the "aid overcomes lack of capital and promotes development" hypothesis. The evidence suggests that good internal policy drives economic development and growth. It is becoming increasingly clear both from studying countries that have developed (for example, in Asia) and those that have not, that the problems identified by aid proponents are not the crucial ones for development. The basic preconditions for development are good governance, including the protection of private property, freedom of contract, enforcement of contracts, the rule of law, the authority of law, and the absence of corruption. This list is not exhaustive, of course.[256] Still, it appears that, if these preconditions are present, development and growth will usually follow.

15. These results are not surprising. Economic activity, employment, saving, and capital accumulation will not take place unless there is freedom of contract and enforcement of property rights. Hernando de Soto's analysis of developing nations in *Mystery of Capital* (2000) treats in great detail the problems caused by the absence of formalization and security of property rights.[257] De Soto argues that in under-developed countries much capital is "dead capital" that is not recognized by the legal system. The absence of both secure and formal property rights prevents proper business contracts developing, leads to

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[255] Ibid.
[256] One could add fiscal prudence and sound money, for example.
[257] Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (London: Black Swan, 2000).

reduced opportunities for entrepreneurship, prevents capital secured on property from being invested within businesses, leads to corrupt legal and governmental systems, and leads to "private law enforcement" or "mafia gangs" becoming dominant. In such a situation, issues such as land reform, and the provision of capital through aid become irrelevant to development. Unless legal systems are reformed to properly recognize freely acquired property, capital investment and land endowments for the poor will have no meaning and will not contribute to development. Exchange relationships are clearly necessary for an economy to develop beyond subsistence level. If contracts are not enforceable in the courts or recognized by legal systems, or if corruption or violence leads them to be enforced perversely, then exchange relationships cannot develop. Similarly, if property rights are not enforced justly or are not recognized, only very limited capital investment can take place. The World Bank 2010 *Doing Business* report ranks all countries by the ease of doing business. African countries have an average rank of 139 in the world compared with OECD countries that have an average rank of 30. It should be said that African countries are now among the top reformers, and reform certainly translates into higher economic growth, as well as a safer society. If obstacles to business are too high, one effect is that an exchange economy can descend into a subsistence economy leading to abject poverty. However, difficulties in registering businesses can also increase opportunities for brutal exploitation. If a business cannot easily register, it may pay bribes to officials, thus corrupting public life. It will also mean that employees, customers, and suppliers cannot enforce contracts through the courts (because the contracting entity does not exist according to the law). Contracts in such an environment can be enforced, to put it euphemistically, "privately" (at gunpoint). This can create a miserable quality of life. The relationship between economic freedom and growth is well documented.[258] One particular statistic is compelling. One hundred countries were studied from 1980 to 2000 and their legal systems rated according to the criteria established by the Fraser Institute's *Economic Freedom of the World* index. The top twenty-four countries had an average GDP per capita of $25,716 at the end of the period and average economic growth of 2.5%. The bottom twenty-one countries had an average income of $3,094 per capita and average economic growth of 0.33%. The criteria used to rank legal systems were: consistency of legal structure, protection of property rights, enforcement of contracts, independence of judiciary, and rule of law principles. This suggests that development is impossible without the basic legal structures necessary for free economic activity.

Question 2

16. It is difficult to find examples of countries that have experienced sustained growth after a surge in development aid. However, it is relatively easy to find countries (and regions) that have been equally poor and experienced growth despite not receiving development aid. Depending on what definitions are used, it is reasonable to say that the number of very poor has fallen by around 500 million to 1,000 million in recent years. The number of very poor in China alone has fallen by between 250 million to 400 million. Other Asian countries such as Vietnam have also seen astonishing declines in absolute poverty. Such Asian countries account for the overwhelming share of the reduction in absolute poverty in recent years, yet they were not among the top 30 recipients of US foreign aid between 1996 and 2006 and were not substantial recipients of UK aid. The rapid growth that has been seen in India can be traced back to the post-1991 economic reforms and certainly not to foreign aid.

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[258] See, for example, James Gwartney and Robert Lawson, "What Have We Learned from the Measurement of Economic Freedom," in *The Legacy of Milton and Rose Friedman's* Free to Choose, eds. Mark Wynne, Harvey Rosenblum, and Robert Formaini (Federal Reserve Bank of Dallas, Texas: 2004)

Question 5

17. Both supporters and opponents of aid agree that policies to tie aid to economic reform have not succeeded where economic reform is initiated by the funding body.[259] There are many reasons for this. It is too easy for countries to demonstrate, at the time that grants or loans tied to structural adjustment are being renewed, that progress has been made—even though progress is more apparent than real. Also, lenders and donors find it very difficult not to renew loans or grants if a country has become poorer because economic reform policies have not been followed.

Questions 8 and 9

18. In an ideal world, the provision of aid might simply work to raise the income of all poor people in a country by an equal amount. People living at subsistence levels would then have more money to save, invest, and provide education and healthcare for their families. However, aid does not work like this, partly because it comes from governments of donor countries and is spent through governments of recipient countries, leading to the effects described above. But it is also not symmetrical in its effect on different economic sectors. This is especially the case, paradoxically, when aid is spent wisely. For example, if aid is spent on investment projects, it can lower the marginal rate of return from investment projects financed by private saving and thus reduce private saving and investment. In any event, aid will raise the real rate of exchange in a country, thus reducing the competitiveness of export sectors.[260] Other non-export-orientated sectors may benefit, of course, but any structural adjustment caused by significant changes in aid may cause problems for particular sectors of the economy.

19. With regard to assistant from philanthropic sources, it is sobering to note that US philanthropic assistance is greater than the government aid from all OECD countries put together. One would expect philanthropic assistance to assist countries to a much greater extent than government aid partly because it largely bypasses the governments of the recipient countries but also because there is better accountability on the part of the donors themselves (the UK government is only weakly accountable to the electorate for the success of its foreign aid programme but charities have to attract donations from their donors by demonstrating the success of their projects). Much philanthropic help is in the form of remittances that goes directly to (very often very needy) families in recipient countries. It is worth noting that one fifth of the cost of the eradication of polio was met by one single charity (Rotary International). Philanthropy should not be regarded as a "bit part" player and it may be thought more useful to incentivise certain types of charitable giving to a greater extent rather than provide development aid.

June 2011

[259] See Erixon, *Aid and Development*, and the references therein.

[260] This may seem like an esoteric point but a research paper (Raghuram G. Rajan and Arvind Subramanian, "What Undermines Aid's Impact on Growth," NBER Working Paper No. 11657, National Bureau of Economic Research, US, 2006) suggests that it can be of fundamental importance, particularly if aid flows are considerable in a country that has had little development. Gupta, Powell, and Yang provide a good discussion of these issues. They note that trade liberalisation should coincide with increases in aid to reduce the impact of the "real exchange rate effect" (Sanjeev Gupta, Robert Powell, and Yongzheng Yang, *Macroeconomic Challenges of Scaling Up Aid to Africa: A Checklist for Practitioners* (Washington, D.C.: International Monetary Fund, 2006). Pattillo, Gupta, and Carey note that this effect can be most detrimental to the poor, though they also suggest that it can be avoided through good policy choices in other areas (Catherine Patillo, Sanjeev Gupta, and Kevin Carey, *Sustaining and Accelerating Pro-Poor Growth in Africa* (Washington, D.C.: International Monetary Fund, 2006).

Lord Jay of Ewelme, Sir Edward Clay and Sir Tim Lankester —Oral evidence (QQ51-81)

Please see under Sir Edward Clay, Lord Jay of Ewelme and Sir Tim Lankester

Kenya High Commission—Written evidence

Introduction

Overseas Development Assistance which takes the form of Aid, Grants, Loans, Private Capital and Philanthropic finances played a curial role in Kenya's development. ODA has augmented our domestic resources in financing development, both social and economic. There are many projects across all sectors of the economic which have financed through donor assistance. Up till early this decade, donors supported our budget by nearly 40 per cent, thus enabling our country to build the necessary domestic capacity to generate internal revenue for development. That our national budget is now over 95 percent financed from our domestic revenue attest to the impact and effectiveness of ODA in economic development.

The evidence before reflect my personal views and observations about the contribution of ODA to the overall economic growth of Kenya. Time allowing, it would have been a good thing to commission a study which I believe would have returned a verdict close to my observation, but backed with facts and figures of its impact on Kenya.

1. In many respects, official development assistance has affected economic growth of our country. ODA has been utilized in road construction projects, modernization of power distribution, rural electrification, water, medical and drugs for fighting malaria and other communicable diseases. Financing infrastructure has helped eased access to health facilities, schools, and other goods and services therefore critical in fighting poverty, disease and ignorance which our country has targeted since independence.

The impact of British ODA has been especially felt in support for governance issues, management of public resources and expanding democratic space which has made a positive contribution to political accountability and relatively peaceful election and political transition. This has enabled civil society and private sector take a more active role in civic education, and fighting high level corruption and impunity.

British ODA has also been instrumental in the success of Free Primary Education programme, with well over 6 million children gaining access education. Support for public financial management has contributed to improved linkages between plans and budgets. British ODA has also played a significant role in the health sector especially in the fight against HIV-Aids – through strengthening the National Aids Control Council (NACC), which has led to increased use of condoms in urban areas and overall management of the pandemic. Other sectors where British ODA has played a significant contribution is in agriculture, rural access to roads, environment, among others. You will notice that most of the people affected in the above sectors are mainly the poor, and by addressing these sub-sectors it helps them out of poverty.

2. There is a clear indicator that countries that receive high level of ODA also register higher levels of economic growth. But added to the volume of ODA would be sound financial management practices and sticking to the laid down plans. If the GDP growth figures are to be taken at the measure of well being, comparison of East African countries, who are Kenya's neighbours, would clearly show this. Statistics from OECD – DAC show

that Tanzania received ODA to the tune of US$2936; Uganda US$1786 and Kenya US$1783. The respective average GDP for 2008 to 2010 was 6.6% for Tanzania, 7.2% for Uganda and 3.3% for Kenya. Countries like Egypt have obviously done better because they receive ODA id billions of dollars in comparison to Kenya.

3. Yes there are lessons to be learnt from such countries. There are arguments that ODA creates a kind of dependence syndrome, and as such we would wish to know the secret of their success. Obviously such countries might have succeeded in settling a sound Macroeconomic platform for further growth thus enabling them to wean themselves off ODA. We would also wish to learn the delivery mechanism used the quantity and quality of ODA, and the impact on the poor who are the target population. Another lesson would be in the governance structures put in place to ensure effective use of ODA; and the inter-relationship among the various investments and their contribution in enhancing the well-being of the people or the economic resource endowments of those particular countries.

4. The major determinants of ODA in recipient countries are the physical assets or lack of such physical assets as roads, railways, and other transport networks, etc. In situations where these are lacking, ODA effectiveness will be less. In the case of our country, most of the physical infrastructure especially roads and railways have for a long time been in a state of disrepair. And therefore, most of the ODA in the recent past has gone into rehabilitation before we can consider expansion. The Social structure in place too determines ODA effectiveness. To some extent, our country's social structures have been fair though not adequate in building a just and cohesive society enjoying equitable development. High literacy rates, access to health care, water and sanitation, the environment, housing and urbanization etc. Other factors determining ODA effectiveness include institutional frameworks – the capacity to plan, organize, implement and operate projects financed through ODA. The policy environment has also significantly improved absorption and capacity to utilize ODA. Kenya has a mechanism for monitoring aid effectiveness. This includes regular donor and government meetings, have drawn up a policy on external assistance, production of annual reports, monitoring results and being mutually accountable for the resources received. We have also enhanced financial management, and introduced new procurement and fiduciary safeguards. In 2006, the government enacted The Public Procurement and Disposals Act 2006. This Act seals most of the loop holes through which donor funding has been siphoned. The Act is being fine tuned to make it full-proof. This will be enhanced by planning, budgeting as well as performance assessment frameworks.

5. To some extent yes, but donor conditions have tended to delay the delivery process of projects founded ODA. Apart from the length procurement procedure, some of the conditionalities are that the recipient country source most of the moveable materials required to deliver the projects from the donating country; and take on technical experts from the donor etc. It has been argued, I think rightly that in excess of 50 per cent of ODA ends up benefiting the donor country through employment and supply contracts. In some incidences, like what happened in Kenya recently – Dfid decided to deliver their support for FPE through NGOs without even consulting the Government. Most of these NGOs are nominated by senior management from donor countries. Of course government is concerned that some of the donor funding is not being put to the right purpose but both the donor and the recipient need to find a solution that is agreeable to all.

6. The ODA allocation should be done in line with the development priorities of the Kenya Government. Our Government has adopted a planning model called Medium Term

Expenditure Framework, in which planning for resource use is done in three year batches. This ensures sustainability in resource utilization. Concerns have been raised in the past that ODA does not fit in very well with the overall government planning, comes late, is fragmented programmes and is not sustainable meaning that government has to keep on negotiating for more. The Millennium development goals have of course highlighted or identified areas on which resources need to be concentrated for actual development to be realized. As programmes under MDG's target actual vulnerable people, ODA allocated along these lines will equally target these groups. The foreseeable future then, ODA allocations need to be shaped by these goals as endorsed in the year 2000, by the 149 Heads of State and Government. We hope that this will be possible within the envisaged timeframe but indicators are that MDGs required a longer time span. By focusing attention on a core set of interrelated goals and measurable targets, it is now easier to track progress and measure the impact of development intervention. On many of the MDGs, Kenya has recorded progress, even though the rate and pace of the country's gains may appear to lag behind other countries.

7. We believe that UN target of rich countries giving 0.7% of GNP in ODA sets a minimum bar and not the maximum. Reaching the target would not mean that recipient countries have reached their saturation point. Our country for instance receives about 0.01% of entire world's ODA, meaning that most of the development programmes including MDGs are still being financed through normal government revenue. Most of the donor assisted countries are still witnessing high population growth rates and therefore their need for assistance will remain around for some time to come. They will need to invest massively in health, education, youth unemployment if their people are to enjoy a fair standard of living.

8. Official Development Assistance does complement private investment in Kenya. Traditionally ODA has focussed on governance, infrastructure and capacity building. But in Kenya we are taking a holistic agenda for development. As such we advocate for more private investment as well because this will expand out GDP, by creating employment opportunities, harnessing local natural resources and has a multiplier effect on the whole economy by unleashing a torrent of entrepreneurial spirit available in the country.

9. ODA interacts very well and complements financial flows from other sources. ODA from Britain has mainly come in for budgetary support for education, health, capacity building among others. For example China was not a significant player in Kenya until 2002; for previously, it was lumped together as 'other donors'. But this has grown significant since then to reach nearly 9% share of all ODA. Grants from China have mainly gone into infrastructure, road reconstruction, energy, and sports facilities. But overall ODA, including private capital flows into Kenya varies greatly from year to year, depending on the country's institutional capacity to absorb funds and delays in project preparation and tendering. But there is a need to properly coordinate, harmonize and align Kenya's and Donor's procedures on ODA delivery; to eliminate duplication and to enhance cost effectiveness in the country.

10. As security has become an international concern, there is need for development assistance to engage with this, both at the national and international level. Insecurity reduces people's productivity, creates fear and uncertainty and threatens a country's stability. ODA is needed in fighting international terror and piracy especially in the Horn of Africa, through channelling some of the financial flows into security related capacity building, and other joint security monitoring activities.

11. The prospects of using Aid to support market-based initiative are good. Areas of support that Kenya would welcome would possibly be insurance against crop failure due to inadequate rains and drought as this would enhance food security, which is quite a challenge in our country. Other areas could be in capacity building for small scale producers who desire to access international markets for their products, drought insurance for pastoralist communities' livestock. It would be a mammoth task if the Kenya Government were to go alone into this kind of scheme. There have been requests from pastoral communities for government to establish such a scheme. The request is still being studied.

12. The British Government can improve the effectiveness of its development Aid by reducing its volatility in terms of commitments and unpredictability in terms of timing and volume of funding. The procedure for disbursement is so cumbersome that even when funds are committed, there may be a long and unpredictable time lags before governments are able to utilize these resources. The second area would be to reduce fragmentation with so many projects taking place at the same time leading to waste in human and financial resources by creating overlaps, duplication and inconsistency across projects and programmes. Fragmentation is responsible for high transaction costs and high workload.

Mr Ephraim Ngare, High Commissioner

16 June 2011

Sir Tim Lankester, Sir Edward Clay and Lord Jay of Ewelme—Oral evidence (QQ51-81)

Please see under Sir Edward Clay, Sir Tim Lakester and Lord Jay of Ewelme

Legatum Institute—Written evidence

Foreign Aid: Time to End It

About the Legatum Institute

The Legatum Institute is a London-based independent, non-partisan organisation that researches and advocates for an expansive understanding of global prosperity. It is a market-friendly think tank that is committed to the reduction of poverty around the world. Our flagship product, the Prosperity Index, is the world's only global assessment of wealth and wellbeing.

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Aid Has Failed to Stimulate Growth in Africa

1. Between 1975 and 2005, per capita aid to Africa averaged $24.60 per year. By contrast, in China it averaged $1.50 and in India $2.[261] Over the same time period, the compounded average annual GDP growth rate per capita in China was 7.9 percent and in India 3.5 percent. In Africa it was a negative 0.16 percent.[262] The importance of growth cannot be overemphasized. There is not a single example of a country emerging from widespread poverty without sustained economic growth. As University of Oxford professor Paul Collier writes, "Growth is not a cure-all, but lack of growth is a kill-all."[263] Growth cannot solve all problems in the developing world, but without growth there can be no lasting solution to the challenges faced by developing countries.

2. Thus, Martin Ravallion and Shaohua Chen of the World Bank write, between 1981 and 2005, the number of people with an income below $1.25 per day in China declined from 84 percent to 15.9 percent, reducing the absolute number of poor from 835.1 million to 207.7 million. In India, poverty declined from 59.8 percent to 41.6 percent. (Because of

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[261] Figures are in current dollars. World Bank, "World Development Indicators Online," http://publications.worldbank.org/WDI

[262] Ibid.

[263] Paul Collier, The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It (Oxford, UK: Oxford University Press, 2007), p. 190.

population growth, however, the number of poor rose from 420.5 million to 455.8 million.) In Africa, the poverty rate declined slightly from 53.7 percent to 51.2 percent. As in India, population growth increased the absolute number of poor from 213.7 million to 390.6 million.[264]

3. The failure of foreign aid to improve growth rates in Africa has not stood in the way of those who want to see more of it.[265] In 2005, for example, Columbia University professor Jeffrey Sachs unveiled his plan to end extreme poverty around the world by 2025. Rich countries, Sachs argued, should commit themselves to increasing annual aid to the world's poorest nations from $74 billion in 2006 to $135 billion in 2015.[266] Also in 2005, the Commission for Africa called for doubling aid to Africa to $50 billion by 2010 and tripling it to $75 billion by 2015.[267] In the end, the G8 meeting at Gleneagles committed rich countries to doubling aid to Africa to $50 billion per year.

Is There Need for Aid?

4. In the 1950s and 1960s, many development economists believed in the "vicious cycle of poverty" theory, which argued that poverty in the developing world prevented the accumulation of domestic savings (i.e., people in poor countries consumed all of their income and had nothing left to save and invest). Low savings resulted in low domestic investment, and low investment was seen as the main impediment to rapid economic growth. Foreign aid, therefore, was intended to fill the apparent gap between insufficient savings and the requisite investment in the economy. Today's calls for more foreign aid are based largely on the same theory.[268]

5. Yet experience contradicts the "vicious cycle of poverty" theory. Today, many formerly poor countries enjoy high standards of living, while others have stagnated or, in some cases, regressed. For example, the 1960 per capita income in South Korea was $1,226. In Ghana it was $1,378. By 2003 South Korea had reached $15,732, while Ghana had fallen to $1,360.[269] As New York University professor William Easterly writes, "It doesn't help the poverty trap story that 11 out of the 28 poorest countries in 1985 had not been in the

264 Ravallion and Chen define poor as those who live below 1.25 dollars per person per day in 2005 dollars adjusted for purchasing power parity. See Martin Ravallion and Shaohua Chen, "The Developing World Is Poorer Than We Thought, But No Less Successful in the Fight Against Poverty," Policy Research Working Paper no. 4703, The World Bank Development Research Group, August 2008, pp. 33, 35.

265 As William Easterly writes, "Indeed, if any single objective has characterized the aid community since its inception, it is an obsession with increasing the total aid money mobilized. . . . In 1951, the UN Group of Experts calculated exactly how much aid poor countries needed to achieve an annual growth rate of 2 percent per capita, coming up with an amount that would equal $20 billion in today's dollars. Similarly, the economist Walt Rostow calculated in 1960 the aid increase (roughly double the aid levels at the time) that would lift Asia, Africa, and Latin America into self-sustaining growth . . . ('Self-sustaining' meant that aid would no longer be necessary 10 to 15 years after the increase.) Despite the looming expiration of the 15-year aid window, then World Bank president Robert McNamara called for a doubling of aid in 1973, which was repeated at the World Bank in its 1990 World Development Report. Not to be outdone, current World Bank president James Wolfensohn is now advocating a doubling of aid." William Easterly, "The Cartel of Good Intentions," Foreign Policy (July/August 2002): 44.

266 Jeffrey Sachs, The End of Poverty: Economic Possibilities of Our Time (New York: Penguin Press, 2005), p. 296.

267 Commission for Africa, Our Common Interest: Report of the Commission for Africa (London, UK: Commission for Africa, March 2005), p. 327.

268 As Sachs writes in The End of Poverty, "When people are . . . utterly destitute, they need their entire income, or more, just to survive. There is no margin of income above survival that can be invested for the future. This is the main reason why the poorest of the poor are most prone to becoming trapped with low or negative economic growth rates. They are too poor to save for the future and thereby accumulate the capital that could pull them out of their current misery." See Sachs, pp. 56–57.

269 The figures are in 1990 international Geary-Khamis dollars. Angus Maddison, "Historical Statistics for the World Economy: 1–2003 AD," http://www.ggdc.net/maddison/Historical_Statistics/horizontal-file_03-2007.xls

poorest fifth back in 1950. They had gotten into poverty by declining from above, rather than being stuck in it from below, while others escaped. If the identity of who is in the poverty trap keeps changing, it must not be much of a trap."[270]

6. Countries that improve their policies and institutions—by increasing their trade openness, limiting state intervention in the economy, building a business-friendly environment, and emphasizing protection of property rights and the rule of law—tend to grow faster than others.[271] Such countries also tend to attract foreign capital, which can help to increase economic growth.[272] Improvement in policies and institutions also creates a suitable environment for growth in domestic investment. As trust in institutions such as the rule of law and protection of private property grows, people feel more confident investing in the local economy.[273]

7. Today, the size and the scope of global capital markets make Africa's access to capital potentially easier than at any time in the past. Indeed, private capital flows to developing countries now dwarfs aid flows. According to Adam Lerrick of the American Enterprise Institute, "The development banks now supply a mere 2 percent of the average net [capital worth] $200 billion that the capital markets provide."[274]

The Impact of Aid on Economic Reforms in Africa

8. Sub-Saharan Africa is the least economically free region in the world.[275] There is a general consensus among economists that Africa needs to catch up with the rest of the world in terms of economic liberalization. Aid is often intended to promote policy reform, yet it has helped to create disincentives to liberalization for a number of reasons.

9. For example, aid is often driven by foreign policy considerations, not economics. For much of the Cold War, African countries were given bilateral and multilateral assistance on the basis of their geopolitical importance to the West and the Soviet Union. As recent

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270 William Easterly, "Planners vs. Searchers in Foreign Aid," Asian Development Bank Distinguished Speakers Program, January 18, 2006, http://www.adb.org/economics/speakers_program/easterly.pdf. See also William Easterly, "Freedom versus Collectivism in Foreign Aid," in James Gwartney and Robert Lawson, Economic Freedom of the World: 2006 Annual Report (Vancouver, BC: Fraser Institute, 2006).

271 James Gwartney and Robert Lawson, Economic Freedom of the World: 2008 Annual Report (Vancouver, BC: Fraser Institute, 2008), p. 18.

272 Ibid. Hong Kong and Singapore are good examples of economies that liberalized and have benefited from foreign direct investment. They continue to be among the world's freest economies and sought-after destinations for foreign capital. Even China, which needs further liberalization, has progressed much since the start of its economic re-forms in the late 1970s and has received substantial foreign direct investment. In 2006, for example, China received $53.3 billion in FDI—more than all of the foreign aid that will go to Africa in 2010. For Chinese investment figures, see United Nations Conference on Trade and Development, "World Investment Report 2007," October 16, 2007, http://www.unctad.org/Templates/WebFlyer.asp?intItemID=4361&lang=1

273 Again, China may be used as an example. Though China still has a long way to go with regard to institutional reform, protection of property has much improved since the era of Maoism. Partly because of those improvements, gross domestic investment as a percentage of the gross domestic product was 43 percent in 2005. In Africa, by comparison, it was only 19 percent. (It should be mentioned that domestic investment rates reflect, at least to some extent, capital controls that are in place in China and Africa.) For definition of gross domestic investment, see World Bank, "Key Development Data and Statistics: 2006," www.world bank.org

274 Adam Lerrick, "Good Intentions at the Expense of the Poor," Financial Times, August 1, 2006.

275 There are many ways in which economic freedom in Africa is restricted. Many African countries, for example, lack functioning legal systems that protect private property. Africa also remains one of the least integrated regions in the global economy and its private sector is hobbled by some of the most restrictive business regulations in the world. See James Gwartney and Robert Lawson, Economic Freedom of the World: 2008 Annual Report (Vancouver, BC: Fraser Institute, 2008).

American aid to Ethiopia and Chinese aid to Sudan show, geopolitical interests continue to influence aid decisions today.

10. Aid has not led to economic reforms in Africa.[276] In the 1980s, the World Bank started to promote structural adjustment loans that were meant to disburse aid to countries in exchange for their commitment to economic reforms.[277] Such conditional lending soon proved ineffective, in part because aid agencies have no enforcement mechanism, and also because they have a well-known bureaucratic incentive to lend, which undermines the credibility of their conditionality.[278]

11. In fact, aid may also actively retard policy reform. Between 1970 and 1993, for example, the World Bank and the IMF gave Zambia 18 adjustment loans with little or no reforms taking place, forcing World Bank researchers to conclude that "this large amount of assistance sustained a poor policy regime."[279] More generally, two World Bank researchers concluded that "higher aid slowed reform [in the developing world] over the 1980–2000 period."[280]

12. Even in those countries that follow sensible macroeconomic policies, aid appears to have no positive effect and may go so far as to discourage reform. Some World Bank research claimed that developing countries that follow good fiscal, monetary, and trade policies benefit from foreign aid. But that research has been difficult to independently corroborate. Scholars who used updated World Bank data found no positive correlation between foreign aid and economic growth in countries with "good policies."[281] Research

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276 The World Bank's own research was forced to admit as much. According to Craig Burnside and David Dollar, there has been "no systematic effect of aid on policy." See Craig Burnside and David Dollar, "Aid, Policies and Growth," World Bank, Policy Research Working Paper 1777, 1997, p.4.

277 Grants are even less effective in stimulating economic reforms. See Simeon Djankov, Jose G. Montalvo, and Marta Reynal-Querol, "Does Foreign Aid Help?" Cato Journal 26, no. 1 (Winter 2006):17

278 Mobutu Sese Seko of Zaire, for example, obtained nine structural adjustment loans from the aid agencies even though he was personally corrupt and even though he pursued destructive economic policies. See William Easterly, "What did Structural Adjustment Adjust? The Association of Policies and Growth with Repeated IMF and World Bank Adjustment Loans," Center for Global Devel-opment, Working Paper 11, October 2002, http://www.cgdev.org/content/publications/detail/2779. As Ian Vásquez of the Cato Institute notes, aid agencies in some cases temporarily cut off spending, but later resume it. They are "in the awkward position of trying to discourage bad policy and encourage policy change through loan cut-offs and, at the same time, trying to encourage policy change through the release of more aid if a country promises such change. Yet releasing that aid would once again jeopardize reforms. Not releasing that aid, on the other hand, would mean that policy change would occur without aid and thus run the risk that the agencies would be viewed as irrelevant. From an institutional perspective, lending agencies simply cannot afford to let developing countries reform on their own. Both the aid institutions and the recipient governments know this, thus further reducing the credibility of so-called conditionality." See Ian Vásquez, "Official Assistance, Economic Freedom, and Policy Change: Is Foreign Aid Like Champagne?" Cato Journal 18, no. 2 (Fall 1998): 282.

279 David Dollar and William Easterly, "The Search for the Key: Aid, Investment, and Policies in Africa," Development Research Group, World Bank, 2000, http://www.worldbank.org/html/dec/Publications/Workpapers/wps2000series/wps2070/wps2070.pdf. See also Danny Rodrik, "Understanding Economic Policy Reform," Journal of Economic Literature 34 (March 1996): 9–41.

280 Jac Heckelman and Stephen Knack, "Foreign Aid and Market-Liberalizing Reform," World Bank Policy Research Working Paper 3557, April 2005, p. ii.

281 William Easterly, Ross Levine, and David Rodman, "Aid, Policies and Growth: Comment," American Economic Review 94, no. 3 (2004): 774–80. More-over, Harold Brumm of the United States General Accountability Office concluded that foreign aid retards growth even in countries that follow sensible policies. Harold J. Brumm, "Aid, Policies, and Growth: Bauer Was Right," Cato Journal 23, no. 2 (Fall 2003). Similarly, in a comprehensive review of foreign aid, Raghuram Rajan and Arvind Subramanian of the IMF found "no evidence that aid works better in better policy [environments]." Raghuram G. Rajan and Arvind Subramanian, "Aid and Growth: What Does the Cross-Country Evidence Really Show?" International Monetary Fund Working Paper WP/05/127, June 2005, http://www.imf.org/external/pubs/ft/wp/2005/wp05127.pdf

suggests that when governments do decide to undertake economic reforms, they tend to do so because of domestic factors, including economic crises.[282]

Problems with Aid Delivery

13. Most major economies have an independent aid agency. Sometimes, countries give aid on different levels. The European Union, for example, gives aid through the European Commissioner for Development and Humanitarian Aid. So do many EU member states, including Austria, Denmark, Finland, France, Germany, Great Britain, Ireland, Holland and Sweden. Moreover, the Europeans have a strong voice on the governing boards of the World Bank and IMF. In addition to those official agencies, there has been a massive increase in the number of aid-promoting non-governmental organizations (NGOs).[283] But effective and efficient delivery of aid has, so far, proved to be an insurmountable challenge.

14. The "aid industry" provides employment for many thousands of people.[284] Consequently, a large percentage of the money spent on foreign aid goes to cover overhead costs, including administration, travel, accommodation, etc.[285] Michael Maren, a former aid worker, writes that the money spent on aid bureaucracies creates perverse incentives. "We have to take advantage of this famine to expand our regular program," argued one aid official that Maren encountered in Africa. She saw hunger and poverty as "a growth opportunity." "Whatever the original intentions," Maren notes, "aid programs had become an end in themselves."[286]

15. Moreover, dealing with a multitude of donors and aid agencies, all of whom require some degree of attention, puts an enormous strain on African bureaucracies. The time and effort spent on dealing with the needs of the foreign donors rather than dealing with the needs of the populace has further distanced African governments from their electorates.[287]

16. The multitude of donors sometimes also results in "duplication" of their efforts. USAID, for example, has "produced a report on corruption in Uganda in 2001, unaware that British analysts had produced a report on the same topic six months earlier." Similarly, in the

282 Anne Krueger, The Political Economy of Policy Reform in Developing Countries (Cambridge, MA: MIT Press, 1993), and Deepak Lal, "The Political Economy of Economic Liberalization," World Bank Review 1, no. 2 (1987), have analyzed the circum-stances under which past liberalization in the developing world took place. In Africa, for example, Mauritius liberalized its economy because of domestic considerations and not because of the urging of aid agencies. In the 1960s, the economy of Mauritius was heavily dependent on sugar exports. The falling revenues from sugar exports and booming population resulted in falling incomes that led to riots in 1967. As a result of those riots, the government undertook a number of economic liberalization measures that included the establishment of Export Processing Zones in 1970.

283 In 2006, there were some 40,000 NGOs worldwide. Three thousand NGOs had a consultative status at the United Nations—three times more than in 1995. See Lerrick, "Good Intentions at the Expense of the Poor." Also, the United Nations Online Network in Public Administration and Finance contains information on 2,500 aid-promoting NGOs, dealing with African problems ranging from agriculture, health and education, to micro-credit and HIV/AIDS. See United Nations Online Network in Public Administration and Finance, "Directory of African NGOs: 2006," http://www.unpan.org/NGO-Africa-Directory/index.htm.

284 The World Bank alone saw its staff expand from 657 people in 1960 to 10,000 people in 2002. See Easterly, "The Cartel of Good Intentions," p. 44.

285 The U.S. Government Accountability Office, for example, found that 65 percent of the U.S. food aid budget went to overhead. See "Feasting on Famine," *Investor's Business Daily*, May 15, 2007, http://www.ibdeditorials.com/IBDArticles.aspx?id=264123350777343.

286 Michael Maren, *The Road to Hell* (New York: Free Press, 1997), p. 9.

287 The Tanzanian government, for example, churns out 2,400 donor reports and deals with about 1,000 donor missions per annum. As a consequence, some governments have in the past declared "donor holiday," when the donors' access to government officials is restricted. See Easterly, "The Cartel of Good Intentions," p. 43.

early 1990s, "Tanzania was implementing 15 separate stand-alone health sector projects funded by 15 different donors."[288]

17. Moreover, many foreign donors have their own agendas that may be detrimental to the welfare of the African people. Like the 19th-century European missionaries who went to Africa to spread their vision of a "good life," modern day aid missionaries have found in Africa a fertile ground for social experiments that would never be accepted in their home countries. Tanzania, for example, is still recovering from an attempt to centrally plan the economy, the so-called "Ujaama" policy of collectivization that was bankrolled to the tune of $10 billion by the socialist governments in Scandinavian countries in the 1970s and 1980s.[289]

18. Research suggests that aid also increases government spending in the recipient countries.[290] In many cases, much of the additional spending ends up in the pockets of government bureaucrats instead of reaching the intended beneficiaries. Between 1991 and 1995, for example, schools in Uganda received only 13 percent of the school grants that Uganda was given by the donor community.[291]

19. Aid encourages rent-seeking in recipient countries. Special interest groups and individuals focus their efforts not on being productive, but on lobbying government officials in order to get access to aid. In that way, aid reduces potential economic output and encourages corruption and political conflict.[292]

20. Moreover, by transferring resources to favoured projects of government officials, competition among domestic producers is undermined. As a result of government favouritism, parts of the domestic consumer base may become captive to firms that provide shoddy and expensive goods and services. Similarly, aid can undermine the international competitiveness of African exports by artificially strengthening the local currency.[293]

21. Finally, the aid community lacks accountability and feedback. Very few aid agencies and virtually no individuals are directly responsible for specific outcomes. Independent evaluations of the effectiveness of donor efforts to alleviate poverty or to arrest the spread of disease, for example, are very rare. Moreover, the donors often determine what they will supply without much regard for what is actually needed. This top-down approach has most spectacularly failed to alleviate poverty in Africa where government accountability is weak and institutional deficiencies extensive.[294]

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288 Ibid.

289 George Ayittey, *Africa Unchained: The Blueprint for Africa's Future* (New York: Palgrave Macmillan, 2005), p. 202. Similarly, some Western NGOs, like Oxfam, have urged African countries not to liberalize their trade regimes even though there is a general consensus among academics that free trade is an important source of economic growth and prosperity.

290 For a review of the literature, see James Njeru, "The Impact of Foreign Aid on Public Expenditure: The Case of Kenya," AERC Research Paper 135 (presented at the African Economic Research Consortium, Nairobi, November 2003), http://www.aercafrica.org/documents/rp135.pdf.

291 Djankov et al., p. 11.

292 Ibid., pp. 9, 11.

293 As researchers at the IMF found, "aid inflows have systematic adverse effects on a [recipient] country's competitiveness, as reflected in a decline in the share of labor intensive and tradable industries in the manufacturing sector. We . . . [found] evidence suggesting that these effects stem from the real exchange rate overvaluation caused by aid inflows." See Raghuram G. Rajan and Arvind Subramanian, "What Undermines Aid's Impact on Growth?" IMF Working Paper, International Monetary Fund, June 2005, http://www.imf.org/external/pubs/ft/wp/2005/wp05126.pdf.

294 As Easterly reminds us, when it comes to aid delivery, it is useful to distinguish between the Planners and the Searchers. He writes, "With free markets and democracy, economic and political searchers find products and public services that satisfy the customers and voters. In autocratic, centrally planned societies, planners produce shoddy goods consumers don't want, and heavily rationed and inferior public services that satisfy no-one. . . . What is the counterpart in foreign aid? Here,

Aid Undermines Democracy

22. Many people, including former UN secretary general Kofi Annan, have argued that aid is needed in order to promote democracy.[295] Stephen Knack of the World Bank, however, found no evidence that aid promoted democracy between 1975 and 2000.[296] (In fact, the aid agencies have repeatedly bankrolled some of the world's most unsavoury regimes.[297]) Other research goes further, suggesting that aid may hurt democratic development in developing countries.[298] That may be the case for several reasons.

23. Aid helps to undermine democratic accountability in Africa, because African governments find themselves increasingly answerable to the donors, not to the public. Government spending proposals, for example, allocate funds in accordance with the advice of foreign experts rather than the wishes of the electorate.[299]

24. Aid encourages military spending. Since aid is fungible, it helps some recipient governments free up resources for military purchases that would otherwise be spent on roads and education, for example. Consider the World Bank's recent contribution of $180 million toward the building of the Chad-Cameroon oil pipeline. Fearing that the oil revenue would be misspent, the World Bank got the Chadian government to commit to spending it on education, health, and infrastructure. What was the result? "The first $4.5 million received as a signing bonus from the oil companies was used to buy weapons—and it is estimated that as much as $12 million may be diverted to buy arms."[300]

25. In fact, Paul Collier found that "something around 40 percent of Africa's military spending is inadvertently financed by aid."[301] Aid may also fuel armed competition for resources. There is some evidence, for example, that Somalia's civil war was prolonged by the competition between different factions for large amounts of food aid that the country was receiving.[302]

26. A growing number of Africans question the effects of foreign aid on economic growth and democracy in Africa. President Paul Kagame of Rwanda, for example, has recently urged Africans "to be honest about the consequences of aid dependence," for

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Planners announce good intentions but don't motivate anyone to carry them out; Searchers find things that work and get some reward. Planners raise expectations but take no responsibility for meeting them; Searchers accept responsibility for their actions. Planners determine what to supply; Searchers find out what is in demand. Planners apply global blueprints; Searchers adapt to local conditions. Planners at the Top lack knowledge of the Bottom; Searchers find out what the reality is at the Bottom. Planners never hear whether the Planned got what they needed; Searchers find out if the customer is satisfied. A Planner thinks he already knows the answers; he thinks of poverty as a technical engineering problem that his answers will solve. A Searcher admits he doesn't know the answers in advance. . . . A Searcher only hopes to find answers to individual problems by trial-and-error experimentation. A Planner believes outsiders know enough to impose solutions. A Searcher believes only insiders have enough knowledge to find solutions, and that most solutions must be homegrown." Easterly, "Planners vs. Searchers in Foreign Aid," pp. 2–3.

295 Boutros Boutros-Ghali, "Human Rights and Democratization," United Nations Educational, Scientific and Cultural Organization, http://www.unesco.org/opi2/human-rights/Pages/English/BoutrosGhaliE.html

296 Stephen Knack, "Does Foreign Aid Promote Democracy?" *International Studies Quarterly* 48 (2004): 251–66.

297 According to Easterly, "The world's 25 most undemocratic government rulers (out of 199 countries the World Bank rated on democracy) got a sum of $9 billion in foreign aid in 2002. Similarly, the world's 25 most-corrupt countries got $9.4 billion in foreign aid in 2002." Easterly, "Planners vs. Searchers in Foreign Aid," p. 18.

298 See Djankov et al.

299 Commission for Africa, p. 35.

300 Djankov et al., p. 7.

301 Collier, p. 103.

302 Maren, pp. 103–104.

"what really matters most for socio-economic transformation is private capital."[303] He has called on African governments to create policy environments in which entrepreneurs can flourish. Others, like Ugandan journalist Andrew Mwenda, point to the negative political impact of aid. According to Mwenda, "foreign aid . . . is providing the government with an independent source of 'unearned' revenue. That allows the government to avoid accountability to Uganda's citizens."[304] Unfortunately, when Mwenda spoke out against further aid at the 2007 Technology, Entertainment, Design conference (TED), the enraged Irish musician Bono heckled Mwenda with shouts of "Bollocks!" and "That's bull-shit."[305]

27. In view of growing evidence that aid has failed to deliver growth and democracy to Africa, Western donors should re-evaluate their commitment to further disbursements of aid to the continent.

Dr Marian L. Tupy

9 June 2011

303 Paul Kagame, "Time for Africa to Insist on Defining Its Own Future," *Business Day*, October 3, 2007, http://www.businessday.co.za/articles/opinion.aspx?ID=BD4A577756.
304 Andrew Mwenda, "Foreign Aid and the Weakening of Democratic Accountability in Uganda."
305 Jason Pontin, "TED Day 1: Bono Heckles the Stage," *Technology Review*, June 5, 2007, http://www.technologyreview.com/blog/pontin/17618/.

Ministry of Defence; Department for International Development; and the Foreign and Commonwealth Office—Written evidence

Submission to be found under Department for International Development; Foreign and Commonwealth Office; and the Ministry of Defence

Rt Hon Andrew Mitchell MP, Department for International Development

From: **The Secretary of State for International Development**

To: **The Lords Economic Affairs Committee**

GROWTH IN DEVELOPING COUNTRIES IS GOOD FOR THE POOR AND GOOD FOR THE UK

Key messages:

- High rates of growth and poverty reduction in developing and emerging economies offer opportunities in terms of increasing UK exports and investment, of which UK firms are already taking advantage.
- UK Aid is contributing to this by creating the conditions and opportunities for growth in some of the poorest countries, from which UK firms can benefit now and in the future.

1. **Growth in developing countries, including in LICs, MICs and emerging economies, is both good for the poor and good for UK prosperity**. Poverty reduction relies on economic growth, but growth in developing countries also creates the global markets of the future. The slowing of growth in OECD countries has been accompanied by dynamic expansion in many developing markets, providing new export and investment opportunities for UK business, and offering direct benefits to UK consumers through more affordable imports.

2. **Aid helps create the conditions for sustained growth in LDCs, building infrastructure, a healthy and skilled population, and better economic and political governance**. It contributes to peace and stability, offering more security to the rest of the world, including the UK. Aid supports the creation of a private sector climate conducive to investment, with lower risks and costs, and better governance. Aid benefits the poor, and by fostering the growth of new markets, also benefits the UK.

<u>Global growth, developing countries, and the UK</u>

3. **Global growth has been increasingly taking place outside the OECD.** Emerging economies are driving much of this growth but LICs and many lower MICs are also growing very fast. World economic growth over the last decade has averaged around 2.5% per year, with growth in high income countries below 2%. Developing countries grew by more than 5.5%, and emerging market economies, including the BRICs, by 6%. India grew by almost 8% and China above 10% per year.

4. **LICs have seen a striking reversal in their per capita growth rates, with GDP per capita growing 3% per year between 2001-2010, against de facto stagnation in the preceding 3 decades.** Lower middle income countries more than doubled their per capita growth rate, from below 2% per year to above 4%. In regional terms, SSA grew in per capita terms by more than 2% after declines in the preceding two decades, while South Asia almost doubled per capita growth from about 3 to 5.5%.[306]

5. **Growth in developing countries has enabled large scale poverty reduction with substantial success.** Fast growth in East Asia has contributed to bringing income poverty down from 55% to below 17% between 1990 to 2005; in South Asia from 52% to 40%[307]. Forecasts suggest that by 2015, there will be about a billion fewer poor people in Asia than in 1990. Even in SSA, which belatedly showed growth progress, poverty is now coming down, from 58% in 1990 to 51% in 2005, with substantial further progress by 2015 expected.

6. **UK exports to developing economies are important and growing in value.** Between 2000 and 2010, total UK exports of goods have grown by an average rate of 3.4%. However UK exports to developing regions have grown much faster. Over this period UK exports have more than doubled to Sub-Saharan Africa and more than tripled to the BRICs. As a result the share of exports in total UK exports to BRIC countries rose from 2.7% to 6.4% and to Sub-Saharan Africa from 1.7% to 2.7%. Exports to the EU, while remaining dominant, have fallen slightly over the decade from 57% to 54% and with weak prospects for EU growth over the medium term, this share is likely to fall further.

UK Exports by destination[308] (£ million)

	2000	2010	Average growth per year 2000-2010
To EU27	106,230	141,126	2.9%
To BRIC (Brazil, Russia, India, China)	4,968	16,757	12.9%
To SSA	3,170	7,089	8.4%
To South Asia (India, Bangladesh, Pakistan)	2,336	4,504	6.8%
To World	187,157	262,516	3.4%

Similarly, exports of services to these destinations is substantial too, including in sectors such as finance, shipping, travel, insurance, IT, and communications. The share of service exports to BRICs in total service exports from the UK has risen from 2.2% in 2000 to 4.3% in 2008[309].

7. **UK investment in both low and middle income countries has become substantial.** Whereas UK investment in OECD markets has shown a sharp decline since 2007, UK FDI in developing economies has grown strongly. In 2010, 31% of all

[306] Countries showing particularly accelerations in their per capita growth in the most recent decade, relative to previous decades, include Bangladesh, Chad, D.R. Congo, Ghana, India, Lesotho, Mozambique, Namibia, Niger, Nigeria, Rwanda, Sierra Leone, Tanzania and Zambia.
[307] World Bank data using the official poverty threshold of 1.25 $ per day in PPP terms.
[308] Source: UK Trade Info, HMRC
[309] International Trade Centre (ITC) using data from WTO, Eurostat and OECD.

UK FDI outflows went into Africa and 9.5% went into BRICs.[310]. Although FDI figures are volatile and can represent financial rather than physical flows, the scale of investment opportunities particularly in Africa is notably large.

8. **Globalization, including increased trade liberalisation, has offered huge benefits to UK consumers via more affordable commodities.** Consumers in the UK are getting unprecedented access to a huge variety of high quality goods from food and textiles to electronics at prices dramatically lower than ever before.

9. **Growth also makes the world safer**. Rising GDP per capita reduces the risk of conflict. If countries can move from a $250 per capita annual income to $500, they reduce the risk of returning to conflict once peace is established by around half.[311] This not only lowers global risks, but improves the prosperity of neighbouring countries: the average annual cost of one new conflict to a country and its neighbours is over $64 billion.

<u>Growth in LICs and the UK aid progamme</u>

10. **Growth in LICs depends on creating the conditions for wealth creation.** Necessary conditions are investments in health, education and infrastructure, sound economic and political governance, and a good overall investment climate. There is no simple formula for fast economic growth, but some of the key ingredients are well known. The 2008 Commission on Growth and Development report, for example, after studying all countries that achieved growth of more than 7 percent per year for 25 years or more, concluded that political leadership and economic governance were key ingredients, but also stated that "no country has sustained rapid growth without also keeping up impressive rates of public investment—in infrastructure, education, and health".

11. **The Coalition Government is now ensuring that the UK aid programme is strongly focused on creating the right conditions to support resilient and strong growth in the poorest countries.** We invest significantly in the legal, institutional and macro-economic environment, human capital and infrastructure, increasingly in collaboration with the private sector. For example, through innovative and catalytic use of grant financing we have helped mobilise $14 billion of private finance into energy, telecoms, transport, urban and industrial infrastructure projects in poorer economies – for example bringing in finance to build a satellite constellation that will bring broadband across Africa and Asia and mobilising investment along new growth corridors.

12. **UK aid is contributing to a sound policy environment.** DFID actively engages with governments helping them shape the right macro-economic and sectoral policies for growth. Additionally, DFID supports the work of the International Growth Centre (IGC), which advises governments on appropriate fiscal policies to tackle economic shocks, manage the use of natural resources and set in place programmes for balanced

[310] Office for National Statistics, net direct investment abroad by UK companies.
[311] Mack, A. Human Security Project. Submission to DFID, April 2009

and resilient growth. In Ghana DFID is working with the Government to set out the policies to secure its 8% growth target in the non-oil sectors; and is working with the Nigerian government to shape their Sovereign Wealth Fund.

13. **DFID is also contributing to bringing down risks, costs and constraints for investment and business in LICs.** To improve economic governance, DFID is supporting the Extractive Industries Transparency Initiative (EITI) which encourages transparent reporting and use of revenues from extractive industries. There are now 33 implementing countries and 11 fully compliant with EITI standards. It is also directly contributing to bringing down business transactions costs. For example, in Ghana it used to take over 2.5 months for an entrepreneur to register a business. Most recently, with DFID support, that was down to less than 2 weeks, with business registration up by 87% and more than 21,000 businesses created.[312]

14. **The World Bank estimates that a good investment climate can add up to two percentage points to growth rates.** DFID supports investment climate reform programmes which cover improving business and land registration systems, improving commercial justice systems, reforming tax/customs administration, and promoting market development and fair market competition. DFID's current property rights programme will help give access to land to a further 6 million people through improved land registration. Infrastructure also represents a major constraint on firm productivity in Africa[313]. By 2015, DFID aims to cut by half the average crossing time at ten major border crossings in East and Southern Africa. The UK is the biggest donor to the African Development Fund. DFID will provide £567m over the 3 years 2011-13 representing 14% of donor contributions. Over the next three years the African Development Bank plans to construct, rehabilitate or maintain 8,340 km of all-weather roads and 16,545 km of feeder roads; and to connect 365,456 households to a new or improved electricity connection.

15. **DFID is supporting multilaterals to bring trade barriers down across the world, and bring LICs into the global economy, securing opportunities for future trade and investment.** The World Bank estimates that over recent decades, per capita income grew 3 times faster in developing countries that opened up their markets than in those that maintained barriers to trade. DFID strongly supports efforts for remove trade restrictions across the world, while at the same time ensuring that poor countries can take full advantage of free trade. Through our aid for trade and private sector development programmes, we enabled poor countries to maximise the benefits of greater market access. For example the Africa Free Trade Initiative (AFTI) helped to support the one-stop border post at Chirundu between Zambia and Zimbabwe. This has reduced the time to complete border-crossing procedures from 3 days to 3 hours. DFID aims, by 2015, to cut by half the average crossing time at ten major border crossings in East and Southern Africa.

16. **DFID helps sustain trade during global downturns, by supporting trade finance to LICs with these countries.** It supports multilateral institutions such as the IFC to provide liquidity for trade finance. For example it has supported the IFC in

[312] World Bank, "Doing Business Indicators", Ghana.
[313] World Bank, "Africa Infrastructure Country Diagnostic", 2010

their support for trade finance for LICs during the financial crisis of 2008/09, and is supporting efforts to step in again during the current downturn.

17. **DFID has been successful in creating new markets with direct benefits to LICs as well as global investors.** In line with DFID's strong commitment to combat climate change effectively, it is supporting the efforts to build markets for investment into low carbon opportunities in the poorer countries. A large new programme will help underwrite the market for renewables in Africa and we are providing cornerstone financing to help the Asian Bank and the World Bank's International Finance Corporation raise new equity funds for climate investments in developing markets. Another example is DFID's work via CDC.

18. **UK firms have been successful in investing in key sectors in LICs where efforts have been made to increase transparency.** There are numerous UK extractive companies that are investing in key sectors where efforts have been made through the EITI to increase transparency in the sector, eg Shell (in Nigeria, an EITI compliant country), British Gas in Tanzania (a candidate country) and Rio Tinto in Mozambique.

19. **UK firms have been successful in gaining orders where open tendering takes place and aid is untied**. Much funding is channelled via multilaterals who then purchase through competitive and transparent procurement. Much of this procurement is from developing countries themselves. However, where local firms are not appropriate sources of supply, UK firms, particularly in the service sector, appear very successful in these tenders. For example in 2010 the UK was in the top ten of supplying countries to the UN system, providing goods and services worth US$ 490 million (compared to US$ 443 million provided by French companies). This is a 265% increase on the 2006 UK figure.

17 January 2011

Professor Oliver Morrissey, CREDIT and School of Economics, University of Nottingham—Written evidence

1. Although numerous studies have explored the effect of aid on economic growth the evidence is not robust; it would be wrong to claim that aid evidently contributes to increased growth, but would be equally misleading to claim that aid has no positive impact on growth. This absence of robust results is typical of the cross-country growth regression literature in general – few if any variables are consistently significant determinants of growth (investment is the strongest candidate for a robust determinant, so aid is more effective when it finances investment).

2. However, there are a number of regular results. The first is conditional effectiveness: controlling for mediating factors (such as policy, or vulnerability to shocks), aid is often found to be positively associated with growth. For example, aid appears to be more effective in countries that maintain stable macroeconomic policies (e.g. relatively low inflation and deficits). Countries that are very susceptible to adverse shocks, such as due to commodity prices or climate (droughts or floods), are less able to maintain macroeconomic stability. In these cases, aid will be more effective if it can be used to address the costs of the shocks.

3. The second regular result is to the extent that aid is used to finance investment, such as building infrastructure, it contributes to growth. The underlying constraint in many low-income aid dependent countries is that the productivity of investment (public and private) is very low. This relates to the previous point: the low productivity of public investment goes a long way to explain the small impact of aid on growth. There is no consistent evidence on how aid relates to private investment. However, there is evidence that public investment 'crowds in' private investment in low income countries: improvements in infrastructure, utility supply, telecommunications and human capital attract private investors. To the extent that aid supports this it helps to make economies more attractive for private investment (foreign or domestic).

4. The third result is broader: to the extent that aid finances social sector spending (the delivery of public goods such as sanitation, education and health) it is associated with improvements in human development (households are better off than they would otherwise be and levels of human capital are enhanced). The underlying constraint in many low-income aid dependent countries is that the efficiency of public social spending is low, i.e. increased spending has a weak effect on improving outcomes (such as health status or educational attainment). Social spending would have very little impact on growth in the short to medium term, but investment in human capital is essential for long-run growth. Thus, the effectiveness of aid should not be assessed solely against medium term growth.

5. In general aid should be targeted at low-income countries only as these have the greatest need for external resources. The MDGs are useful insofar as they help identify where needs are greatest. However, there is apparent confusion on how to react to countries falling short of MDG targets – does one punish them for not trying hard enough, or should one acknowledge specific constraints they face? One needs to know why a country is not achieving progress on MDGs. The MDGs are less likely to be achieved and aid is less effective where government systems are very weak (especially in conflict or politically unstable environments) or where the government evidently does not share donor

objectives; in these cases humanitarian aid is more appropriate. Aid is most effective when it supports committed governments, especially in post-conflict situations; these may not be meeting MDG targets because of the severity of problems and lack of domestic capacity and resources, so are appropriate for aid targeting.

6. It is not feasible to distinguish an effect of British aid on growth in the context of cross-country regression analysis (one cannot distinguish individual donor effects). One can observe that Britain, and especially DFID, has built a sustained aid relationship with a number of sub-Saharan African (SSA) countries that have performed reasonably well over the past decade or so despite not being resource-rich, e.g. Ghana, Mozambique, Rwanda, Tanzania and Uganda. One can also observe that DFID has been committed to targeting aid to social sector spending, especially water and sanitation, that has a demonstrated benefit for human development. Britain has also been willing to commit and maintain aid to post-conflict reconstruction; once conflict is over aid can be very effective provided it is sustained for about ten years. One could therefore infer that the impact of British aid over the past 10-15 years has been at least as good as that of any other donor.

7. At the macro (economy-wide) level factors that are conducive to growth and development enhance aid effectiveness (measured as the association between aid and economic growth). These include macroeconomic stability, control of corruption, political stability and improved public sector expenditure management systems. In general the form of aid is not so important as long as it supports investment in physical and human capital and delivery of public goods and services.

8. At the sector level, e.g. health, education and agriculture, the effectiveness of aid depends on the quality of the government systems in the sector and the ability of donors to work with, rather than against, these systems. Prior and sustained capacity-building is essential to make sector aid effective. While sector-specific performance indicators are appropriate means to assess the impact of sector aid these should reflect objectives actually addressed by the aid projects. In particular, performance indicators should relate to inputs rather than outcomes (as many other factors determine outcomes and these are not 'controlled' at the sector level). For example, the number of vaccines administered rather than measured reductions in disease mortality, or agriculture extension services provided rather than yield outcomes. The outcomes should of course be observed, but to assess sector constraints rather than aid effectiveness as sector aid has input objectives.

9. Some specific project interventions are amenable to assessment by randomized controlled trials (RCTs). For example, these may be appropriate for assessing the impact of microcredit or insurance schemes, conditional cash transfers or methods to improve teacher performance. However, RCTs are no panacea: the method is not appropriate in many cases, it is very expensive (especially as the assessment is specific to the intervention context), it raises ethical concerns and alternative methods can often yield as reliable an assessment.

10. It is difficult if not impossible to assess the impact of aid surges against a similar country that did not receive an increase; aid surges are not experiments where one can identify comparable control and treatment countries. In part this is because one needs to know why aid increased and in part it is because it is often not the volume of aid *per se* that has an impact but the associated policy actions and uses. In the 1980s and 1990s aid flows to many countries increased as they agreed adjustment programmes, some of which were more successful than others for reasons that are largely country-specific. Over the past decade or so, surges have often been associated with conflict or post-conflict situations.

Ongoing conflict is likely to seriously undermine the effectiveness of aid, but as observed above (6.) sustained aid post-conflict can be beneficial. Some aid surges are better than others.

11. The evidence on the effect of policy conditions is limited, because the cause-effect chain of conditionality is inherently difficult to identify. Conditionality may have few observed effects on performance because: i) the conditions were not fully implemented; ii) the conditions were implemented but transpired to be inappropriate or had unintended effects; and/or iii) unanticipated events undermined performance. Furthermore, conditionality typically involved multiple conditions across numerous policy dimensions for which compliance varied and there may be inter-related effects. Interpreted strictly, conditionality is not effective: the *quantity* of aid is not a determinant of the *quality* of policy, or the specific reforms advocated by donors are rarely fully implemented within the relatively short time period of the associated aid programme. However, there is considerable evidence that the direction and broad content of reform for the majority of recipients is in line with what donors advocated, i.e. aid conditions have influenced the trend in policy over time. Exchange rates and trade policies are two examples for SSA: in the early 1980s most SSA countries had multiple officially controlled exchange rates and very distorted trade policies, whereas by the late 1990s most had floating exchange rates and had significantly liberalized trade policy.

12. Conditions related to monitoring public expenditure and the use of aid do appear to have been effective. For example, improved public expenditure planning and fiscal management systems implemented in many SSA countries have reduced the extent to which aid is fungible and enhanced the link between aid and government expenditure to increase delivery of targeted goods and services. DFID has promoted and supported such public sector management reforms and appears to have greater confidence in the ability of the recipients it works closely with to manage public expenditure and reduce the fiduciary risk associated with aid.

13. The global environment when the East Asian economies graduated from reliance on aid, i.e. the sustained growth from the 1960s to become middle-income countries, was very different to the environment facing low-income countries today but some lessons are relevant. The East Asian economies all maintained stable macroeconomic management and 'getting agriculture right' was an important first step, often associated with early land reform although also benefiting from the Green Revolution (which largely missed SSA). Most of the successful countries still have some strong agriculture sectors, almost self-sufficient food production and/or cash crop exports. Diversifying the economy to expand manufacturing exports was also important. Arguably, SSA countries failed in the latter because they failed at the former: productive agriculture generates the inputs for an agri-processing sector that can provide the initial platform for manufactured exports (this is generally more feasible than processing minerals to add value).

14. The main problem with global aid allocation is the lack of coordination among donors rather than the volumes of aid. The tendency of numerous donors with different objectives and aid management systems to maintain multiple operations in a country (especially the most 'popular' aid recipients) imposes high coordination and transactions costs on the recipient, even when the aid can be absorbed usefully. Ethically, the 0.7% target is reasonable, although the number itself has no particular significance (it could be 0.5% or 1.0%). If all donors met the target it would not generate a global excess of aid funds.

15. The best way for Britain to maintain and improve the effectiveness of its aid is to ensure that the objectives are specific and transparent and related to actions associated with the aid (inputs) rather than to ultimate outcomes (one assumes the donor has already verified that the specific inputs are associated with the ultimate outcome). If the aid is achieving the policy input targets, such as training teachers or vaccinating children, it has the intended effect. If the outcomes are less than expected, further investigation to identify the new binding constraint is required. Country-wide objectives are undesirable because whether or not they are met it is difficult to identify an effect due to aid.

27 June 2011

National Audit Office—Oral evidence (QQ 365-398)

Evidence Session No. 11. *Heard in Public.* *Questions 365 - 398*

TUESDAY 15 NOVEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Lord Lawson of Blaby
Lord Levene of Portsoken
Lord Lipsey
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Amyas Morse, Comptroller and Auditor General, National Audit Office, and **Mark Andrews**, Director, DfID Value for Money Studies, National Audit Office.

Q365 The Chairman: Good afternoon gentlemen, this is the 11th public hearing of our inquiry into the impact and effectiveness of development aid. We are very grateful to have you back, Mr Morse, and we welcome Mr Andrews, who I understand is the NAO expert on DfID. Welcome to you both. If you are agreeable, we will go straight into questions, unless there is anything that you wish to say. We have obviously read a great deal about your report and that of the PAC. Our inquiry concentrates on the impact and effectiveness of development aid and, therefore, the key test for us is value for money and having proper systems in place. I therefore think that this hearing today is of particular importance for us. We have read with great concern your report of April this year on the Department for International Development and the recent PAC report that followed it. Both are pretty devastating in terms of past performance, but are also very worrying in the context of the commitment to increase spending on aid by a third, in real terms, over the four-year period.

We will be asking a lot of detailed questions, but let me start with a general one. The sense that I get is that there will have to be a huge cultural change in the department if it is to achieve results in effectiveness and value for money. You say that we will "face significant financial and operational challenges, making sound financial management essential". You also say: "Fraud and corruption present a risk to the reputation of the Department and are threats to development impact. The Department is too reactive and cannot provide Parliament and the taxpayer with a clear picture of the extent, nature and impact of leakage". My general question is this: is the general quality of financial control and risk management in the department worse or even significantly worse—perhaps for historical and cultural reasons—than in other departments of government? Is the department capable of meeting the challenge in the timescale?

Amyas Morse: Thank you, my Lord, and thank you for your invitation. I think that the way you pose the question paints the situation in a grimmer light than I would want to. The Department's financial management is not significantly worse than that of other departments, but it is obviously conducting a different business from other departments. My general comment is that there are areas that need improvement, but I would say to you that sometimes my experience is to look at a department and think that it does not get it. I do not think that about DfID. Broadly, I think that it realises the challenge it faces and what it needs to do to solve that challenge. The question is—and I do not have an answer to it—can it achieve that rate of improvement in the time available to it? There are significant challenges, as you rightly say, and our report raises those issues. There are challenges on fraud, particularly if the Department chooses to concentrate on the most fragile states, as government policy has indicated. It is almost concomitant that there are issues of fraud to be addressed. However, my overall comment is that there is a mixed picture and there are areas in which to improve. However, the core financial management has got better. Certainly in my time, I can see improvement. There are gaps, but I think that the aim of travel is in the right direction. I would say that there are very real issues to address, but I am not saying to you that it is hopeless. If DfID can get the angle of climb sufficiently rapidly and take account of those risks more explicitly, as I have reason to believe that it will, I think it is achievable to achieve effective control over this additional level of funding. I am not going to offer an assurance that it will, but I think that it is achievable.

Q366 The Chairman: I use the words "cultural change" because, on reading both your report and that of the PAC, there seems to be a recognition that there had been a considerable change of direction last year with the new Government and that there had been a very different approach to the kind of things that we want to talk about, compared with the past. That is why I wondered—given also the pressure on the Department's spending budget on administration and the need to cut back there—is it not a pretty hefty challenge to turn that Department around?

Amyas Morse: It is a hefty challenge. I do not want to seem as if I am determined to be unduly optimistic, but the cultural change is now going in the right direction. I am confronted by a Permanent Under-Secretary who is a qualified accountant and understands issues of control and has brought forward those elements of his team who have particularly strong financial skills—so they are clearly influential. There are reasons to be quite positive.

I had a meeting with the core management team at DfID earlier this week, as part of a review that I am conducting on all the major departments because of the challenge that they face on audit. More generally, I am having what I call a review meeting with all major departments. The members of the DfID team come over as if they know the challenges and are very determined to achieve them. That is not the same thing as saying they will get there on everything, but I do not think that their heart is in the wrong place or that they do not understand the scale of the challenge that they face.

Q367 The Chairman: A very large number of your recommendations in your report required considerable change in this area. What you are saying is that the Department has taken these on board and, under the new direction from the Government—

Amyas Morse: Taking it on board and getting it all done is not the same thing. While I am giving you the positive view that DfID is aiming in the right direction, it has a considerable amount to do to provide itself with the staffing in the areas that it wants, with the expertise that it needs, to carry out the changes in the risk assessments that we recommend. There are a lot of things to be done, and the fact that the Department has, as I see it, taken these tasks on board is one thing, but getting them done in time to handle the funding and to make sure that we do not have any major mishaps is something else. I am simply saying that they are paddling in the right direction and I am not looking at them and thinking that DfID has no understanding of this problem. The cultural change is under way, and is not something that is simply to be wished for.

Q368 Lord Lipsey: We were noticing a difference in tone between your answer and the way that the Lord Chairman put the question. What was very striking when I read your report for the first time was the contrast between it and the press reports of the Committee's report when it first came out, which suggested that it was extremely damning. Was it just the press getting it wrong or spinning it in a particular way?

Amyas Morse: I cannot answer for the press. I am sure that they have their own insights.

Lord Lipsey: Were you surprised when you read the tone of the press coverage?

Amyas Morse: I thought that it was a lot less balanced than the report, but that is not an extraordinary experience.

The Chairman: Your report was, nevertheless, strikingly critical in various respects.

Amyas Morse: I am not trying to say that it is not critical and that there are no issues to be addressed. That is all true but I am simply saying, regarding the question as to whether DfID has an idea of what it is addressing, my feeling is that it has, but there is a lot to be done.

Q369 Lord Lawson of Blaby: On that last point, I share the Lord Chairman's view, rather than that of Lord Lipsey, that both your report and, perhaps even more so, the conclusions of the Public Accounts Committee were severely damning and critical. I must say that they shocked me. I do not think that the press got the balance wrong in this case, although they are perfectly capable of getting the balance wrong. Perhaps I may first pick up on one of your answers. If I interpret your answer to the Lord Chairman's opening question correctly, bearing in mind the damning comments in your report and in the Public Accounts Committee's conclusions, and—you do not need to reply to this but you could look across the board—if the problems in DfID are no worse than those in any other department, that is pretty shocking for public expenditure as a whole, is it not?

Amyas Morse: If I may, I shall just repeat what I said at the beginning. DfID is dealing with different matters from other departments. Other departments are not trying to distribute aid in some of the most troubled areas of the world and focus now even more on those areas. Other departments are operating, generally speaking but not exclusively, in a much more controlled environment. Therefore, DfID's risk profile is very different. A lot of my comments in the report relate to the assessment of risk and what that risk is in distributing aid. It is not a question of asking: does it have any internal control? Yes, it does, but it is distributing aid in very difficult areas. If I compare that with most of the major spending departments, for the most part it is not the same risk profile.

Q370 Lord Lawson of Blaby: Following on from that, what criteria do you think should be used to assess the value for money that we as taxpayers obtain from DfID's spending programme?

Amyas Morse: I think that DfID needs to have a view of what its high-level VFM measures should be. That is an area where we have urged it to look for the best use of resources achievable in the circumstances. Perhaps I may give an example from our education report. Realistically speaking, we found, as we began looking at the international support for education that DfID was giving, that it was very much focused on supporting programmes that measured primarily the numbers of teachers on the roll and enrolment by pupils. In a difficult environment, we do not think that measuring something like that, which is not an indication of education delivered, is a satisfactory measure. We were very clear in that report that we thought DfID should instead be measuring attainment, hours of education achieved—or something along those lines—and hours in classroom by teachers. We did not think that it was acceptable to have an unchallenging set of measures. I admit that they are better than nothing, but we made it clear to the Department that if it remained like that and did not serve purely as a first place to then progress from, we would be very critical of it. It is progressing beyond that. That is not only a good thing for DfID but it is appropriate in terms of capacity building in the Governments with whom it is working to give those Governments a focus on more meaningful measures of attainment. It is also appropriate for us to measure value for money in that sort of way against what is realistically possible in the environment in which it finds itself.

Q371 Lord Lawson of Blaby: In that context, the Permanent Secretary at DfID, when he was tackled on the value for money question by the PAC said: "For us, value for money means maximising the impact on poverty". This is, in a sense, slightly curious—certainly from our perspective because we thought that this was development aid. Indeed, as an economic committee, we are concerned about how effective the aid programme is in promoting economic development. He did not mention that—just the impact on poverty. Although there is a connection between the two, they are by no means the same thing. I wondered what you felt about this and whether, in fact, he should not have been thinking just about the impact on poverty. You could have a beneficial impact on poverty with a whole lot of handouts, but that does not necessarily promote economic development. Where do you stand on this?

Amyas Morse: First, a lot of people use the expression "value for money" but for us it is a term of art, if I could describe it in that way. It is something we use as a specific measure, rather than a general expression of desirability, which is rather what it sounded like when it was used there. I can understand that the Department finds it desirable to have an impact on poverty, as I understand is the case for a lot of the Department's programmes. I am now referring to the report that we prepared on transferring cash and assets to the poor. DfID is well sighted on the difference between simply giving people a handout and actually achieving something with more sustainability to it. It certainly expresses an understanding of the distinction between the two. Just to come back to the issue, it may use that expression, but when we are writing reports on it and on value for money, we are looking at the optimum use of resources to achieve results that are feasible in the circumstances. There is no variation between the definition that we would use for DfID or any other department.

Lord Lawson of Blaby: It depends what the result is.

Amyas Morse: Sorry?

Lord Lawson of Blaby: You referred to the impact on results. What result are you looking for?

Amyas Morse: It depends on the programme. I am not avoiding your point, but I will first say that obviously the point that I made about education programmes was that we would not regard their impact on results as being capable of easy falsification, such as enrolment figures or simple teacher numbers. Equally, on poverty, if the object of the programme is to have an enduring impact by reducing poverty on a sustainable basis, we would hold the Department to adopting measures that really reflected that, not ones that were conflated with simply giving short-term aid.

Lord Lawson of Blaby: Would your colleague like to add anything to that?

Mark Andrews: I would like to add something. You are right in what you infer, which is that DfID, by and large, has made choices to support public services and their expansion—particularly education and health. They are not uncorrelated to economic growth. Some of the research that we looked at when we compiled our report on education looked at the wage-rate effects of each additional year of education completed, which show that a pupil completing another year of education can typically add 10% to their wage-earning potential, with an obvious potential aggregation effect. But DfID has sought to focus more on the provision of public services, partly as a way of boosting and supporting the development of developing countries' Governments' capacity and partly because of choices that it makes about donor differentiation and where it sees its niche. To some extent, these are policy questions and are a matter for the Department, not us. What we test DfID on is what its logical theory is in terms of the ultimate development impact of particular programmes.

Q372 Lord Lawson of Blaby: One final question. Uniquely, DfID is under a ministerial diktat to increase its expenditure. Do you think that in any way militates against the search for value for money?

Amyas Morse: Not necessarily.

Lord Lawson of Blaby: But in fact does it?

Amyas Morse: Not necessarily is the right answer. As I have described to you, the intention of DfID, as it has clearly expressed, is to have more professionals on the ground. It has reduced the centre but its intention is to have more professionals on the ground to administer these programmes more effectively. If it is capable of doing that—and I do not know if it will deliver it—that model could result in better control. I think that the jury is out on whether it will be able to put those people on the ground, and there are some indications that it may have difficulty in finding people with the appropriate background who are willing to go there. So I am not assuming that it will, but if you say to me, as a proposition, "Is it possible to have this increased budget and manage it properly?" yes it must be so—and I think it is so. Equally, one might ask: is there a risk of getting the capacity to manage the programme and build it up in time to meet that increased budget? Yes, there is definitely a risk as well.

Lord Lawson of Blaby: Thank you.

Q373 Lord Levene of Portsoken: Good afternoon. How do you believe that we should evaluate the value for money of aid to fragile and post-conflict environments? Do you think that this calls for a different approach to evaluation of aid in post-conflict environments from the one used elsewhere in DfID?

Amyas Morse: We certainly accept that evaluation may be more challenging in the most fragile states but in principle we do not think it is fundamentally different. The risk factors are higher but not fundamentally different. Twenty-one of DfID's 28 priority countries are fragile, so operating in these environments is not a new proposition and the approaches should be similar. In practice, of course, there will be challenges. There will be a more limited base of evidence, more difficulty in monitoring on the ground and weaker national measurement systems to see what is actually happening to the funding. It will be very important to be clear what is available and what can be done from the outset and to select methods for providing aid to take account of that. It will be necessary to supplement national measurement with some DfID and donor-led measurement to beef it up as much as possible.

Q374 Lord Levene of Portsoken: Does that mean that fragility and provision of aid tend much more regularly to go together? In other words, there is less aid going to those environments that are not fragile.

Amyas Morse: Certainly, if you look at the increase in aid that DfID is planning, I think that I am right in saying that the majority of that aid will be going to what are classified as fragile states. Is that right?

Mark Andrews: I think that with the recognition of South Sudan there are 11 countries where DfID will be increasing its spend over the spending review period by more than 50%.[314] All 11 of those countries score at three or less in the Transparency International index of perceptions of fraud and corruption. Where DfID's spending increases are the greatest, they are in the most difficult environments to operate in terms of the risk of fraud and corruption.

Lord Levene of Portsoken: Do they have some kind of measure as to what extent their resources are put into those areas that are fragile?

Amyas Morse: I think that they are approaching it on the basis that they have a measure on the basis of poverty and need. It is not so much based on fragility. It happens that fragility normally marches alongside poverty.

Mark Andrews: Perhaps I might just add that part of the rationale, and this is not the only rationale, for DfID focusing on fragile states is that typically the average aid spend per capita is lower than it is in other low-income countries.

Q375 Lord Forsyth of Drumlean: You touched on risk earlier and I think you said that DfID as a department obviously deals with riskier processes and projects than other departments. How do you work out what a reasonable level of risk is in respect of a programme that might be run by DfID?

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[314] Clarification: With the recognition of South Sudan, DFID now focuses on 28 priority countries. Of these, there are 11 countries where DFID will be increasing its spending by more than 50%. Spending projections and a TI index for South Sudan were not available at the time of the NAO's analysis.

Amyas Morse: For a start, we would expect DfID to think about its appetite for risk in a particular programme and its reason for accepting that risk. It might say, "We appreciate that this is a risky territory to be running a programme in. We accept that but we think the need is very great and it is urgent to try to provide aid in this area." They then look to see whether it makes sense and whether it is consistently and logically thought out, and consider whether they have thought through why they are accepting the level of risk and have selected a medium for delivering aid that makes sense and minimises the risk. They should not be afraid of being innovative in that. For example, one of the areas we have seen is the method of delivering direct payments that bypass most of the government mechanisms and go through more or less paying cash through a banking system by direct transfer. They are quite innovative. As you can see from our report there are indications that they can be quite successful. What we would assess is the appetite for risk and the probability of loss and whether the actual performance is that it has been implemented in the most effective and sensible way.

Q376 Lord Forsyth of Drumlean: I understand that. Although that is answering a different question it is helpful to have that answer. My question was: what is a reasonable level of risk or is it just whatever they decide? They might say, "We would quite like to do this project in this very difficult environment; we have worked out that it is highly risky, so because we have a risk assessment and a strategy it is okay." Or is there a level of risk that is not appropriate and therefore you should not be doing the project at all?

Mark Andrews: My answer to that would be twofold. First, what is the calculation of the cost-benefit trade-off on the particular intervention you are talking about? Your risk appetite might well be higher if you can see a many-fold return on your investment if the programme goes to plan. That is one component of my answer. Our starting point is simpler, which is that we would like DfID to put more effort into quantifying and estimating its likely risk levels. We are not even into the debate about what the appropriate level of risk is yet, because DfID is not quantifying the level of residual risk it faces.

It might help if I just stand back and say what DfID does. It carries out a process of what are called fiduciary risk assessments. They are carried out at the level of the country in the round. DfID then makes choices as to how it will deliver aid and typically its choice is, "Will we operate through the Government or not?" When the risk assessment says that it is particularly high risk, it will say, "No we are not operating through the Government." What we would like to see is a programme to be designed and then ask what is the estimate of the risk that you then face—ideally quantified, but certainly with a strong indication of what the particular risk might be and how to control against it.

Q377 Lord Forsyth of Drumlean: Okay. So are you saying that you think it ought to have a view on an appropriate level of risk but that the risk procedures are such that you cannot do that? Your answer, where you say that it might depend on what benefits there would be, suggests that if you put all your money on the black and spin the wheel you might get a very good return. I would not suggest that that was an appropriate—

Amyas Morse: I am sorry, but it is a bit different from that. Let me try to answer again. I shall step back to my experience of doing some work with international banking clients some years ago. What they had was a territory risk weighting and they had thought through what might be the risk in a particular territory. They had that in mind and looked at a project. If they were invited to consider a loan in a particular territory, they said that their risk weighting for accepting a return on this would have to be higher because of the inherent territory risk. We think that it is possible for something as methodical as that to be done by

DfID. It can look at the risk of using the Government in particular territories and say, "Well, realistically, if we are deciding to put the aid here we would like to consider the inherent risk in the programme when deciding whether or not to go with it." In other words, we are not inclined to say, "Well a 20% loss rate is acceptable but 25% is not." That is not possible. What would be possible would be to array a lot of territories with high need and say that, while the risk factors in those territories vary quite considerably, your ability to get money through effectively and to have a relatively low risk of loss in one territory compared to another might weigh in your decision.

Q378 The Chairman: Would that sometimes lead to a decision through the risk assessment not to proceed with particular projects or put such emphasis on particular countries?

Amyas Morse: It would certainly allow a more informed debate on that than takes place now.

Q379 Lord Forsyth of Drumlean: To take your international banking example, which I understand. You look at the risks and take a view. If the capital that is being put at risk does not justify the returns, you just do not do it. The Lord Chairman's question goes to the heart of that. One would expect an organisation like DfID with limited resources and wanting to get best value for money to look at the vast array of projects that are there and to form a view of the risk and the likely return and to have some kind of mechanism in deciding priorities, other than saying, "We know it is risky but we will just do it."

Amyas Morse: Yes. One has to be a bit fair in applying the parallel.

Lord Forsyth of Drumlean: It was your parallel, not mine.

Amyas Morse: That is a perfectly fair comment but, none the less, one is a bank loan with a certain return that you can state and the other is talking about a return in terms of alleviation of poverty and things of that sort, which are very difficult to establish so clearly. There is the idea of having an organised assessment of risk per territory. Although DfID has good relations and has worked hard to build relationships with Governments in a lot of these countries, I do not see why it should not have some thoughts about the risk. It could start there and get better at it. That would be reasonable. To have such a crisp measure as you might find in the banking system might always be difficult.

Lord Forsyth of Drumlean: I can see that, but how would that work? What does it mean? It is not a number.

Amyas Morse: I am hesitant about making up a programme for DfID but if you said to me, "Here are two countries, one with a higher conversion rate of aid going through the government machinery and a better record of that reaching the intended target than the other," although you could not necessarily guarantee or measure very accurately the final outcomes, at least you could say that you had less chance of it leaking off into inappropriate places on its way through. That would allow some relative merit to be determined.

Q380 Lord Best: Staying with the theme of risk, as I understand it DfID is choosing the countries first before deciding on the risk level but not as a banker would, looking at the risk and then deciding to whom to lend. Is there more, though, that a Government can do in choosing those countries to try to ensure that they have in place mechanisms themselves as Governments in terms of audit and financial management of their own affairs? It would not seem unfair to have specific requirements of those Governments if this is direct budget support to a Government. Can we not be a bit firmer before writing the cheque as to the financial probity and audit requirements that we expect at the other end?

Amyas Morse: Of course the answer to that is that we can be firmer. Given that DfID is not in charge of the countries concerned, we have expected that it will say, "We will continue to participate". If I may, I shall go back to a recent education report saying that we expect a progressively firmer way of measuring and delivering these programmes. That is practical politics. By passing aid through the government mechanisms they see themselves as being able to positively influence those Governments. To the extent that we have looked at that in our recent reports, we see examples of them doing that. Should they do more of it? Yes.

Lord Best: Where they make the effort, your view is that that has returns.

Amyas Morse: Over time I believe that it does change. Over time they have influencing but not commanding ability. I am sure that that is what they would say if they were here.

Q381 Lord Lipsey: Obviously different forms of aid have different risks of being ripped off, particularly in fragile or failed states. Would you like to generalise at all about what is less risky or more risky as regards technical assistance? Is sending your consultants over there less risky? Do you think that in constructing its aid programme DfID adequately allows for the differential risks and different forms of aid?

Mark Andrews: I think it is hard to come to a definitive view about the relative risks of different ways of delivering aid, or indeed the relative value for money of different ways of delivering aid. This is one of the directions that we will continue to press for in terms of DfID's focus on the measurement of value for money. They are certainly making strides in terms of new business case procedures and their initial investment decisions in terms of whether the benefits outweigh the costs. There is much more quantification and much more looking for a solid and robust evidence base on which to make investment decisions.

We would like to see them do more, such as compare alternative options in terms of their programme design and ultimately consider alternative options in terms of different forms of support and different mechanisms for that support. Yes, I think it is easy to say that some forms of aid, like technical assistance, are likely to have a lower risk than, say, delivering through the Government. One thing that I would say is that DfID does very little without operating through a delivery chain and many of those delivery chains are quite complex and ultimately involve Government somewhere.

Our recent report on cash and asset transfers shows variation between programmes that are, if you like, 100% DfID-owned and DfID-funded but still operated through managing agents and NGOs, and those programmes that are much more heavily Government-owned, if rarely Government-funded. It is always operating through a delivery chain somewhere. Obviously, the shorter the delivery chain and the more transparent, the more control you can have over it. The key test is to be absolutely clear about the objectives: the logic of the linkage of the inputs—what you are spending—through to intermediate outputs and ultimate development outcomes, and being robust about measuring that.

Q382 Lord Lawson of Blaby: One of our witnesses, who will be well known to you, Paul Collier, is an acknowledged expert in this area. He seemed to suggest that you often get far better value for money in channelling aid through particular NGOs. I think he was thinking in particular of the churches in Africa, rather than channelling it through Governments. Is this something that you have looked at? If so, what conclusions have you reached?

Amyas Morse: I do not think we have looked at that. We have not looked at whether we should be channelling through the churches rather than through Government. Without going much further than that, I would say that some of the intention of channelling through Government is to improve the quality of the Government.

Lord Lawson of Blaby: It might be counterproductive

Amyas Morse: In fairness, I must reflect what the intent of the choice is. Channelling through the churches may have some unlooked-for conditions associated with it as well.

The Chairman: I am afraid that we will have to stop as there is a Division. We shall be back as quickly as we can.

The Committee was suspended for a Division in the House.

On resuming—

Q383 Lord Smith of Clifton: This is really about the potential role of PFI in developing countries. Should aid funds go to direct funding of public expenditure even when a local Government's accountability is good, or would donor agencies such as DfID give better value for money by using their resources to leverage private capital and expertise through public-private partnerships? Does the evidence, including from earlier NAO reports on PFI and PPP initiatives, suggest that public-private partnerships can be effective in delivering public investment in the poorest countries? The Treasury has just announced an investigation of PFIs here and the extraordinary costs involved.

The Chairman: This Committee first alerted the public to that in one of our reports.

Amyas Morse: In my memory we have not carried out a study on PFI in the international aid context. I am aware from my previous life of international turnkey-type projects with private finance for major infrastructure development that such contracts do exist. There is nothing magic about them in terms of where they necessarily deliver different value. DfID regards itself as leveraging by leading others into funding, not through PFI means. That would be what it says but there is nothing inherent against using any method of public-private partnership to leverage funding in a country that is capable of doing that. I would just say that there is nothing magic about it either. It is a potential funding option for projects. Is it possible to do that in such a way that there is a funding stream coming from DfID that could help to underpin a project like that? I think it is possible. Is it necessarily the right thing? It would be entirely a matter of looking on a case-by-case basis.

Q384 Lord Tugendhat: I come back to something that we talked about before. We have seen in Afghanistan and Iraq that a significant share of aid in fragile environments is disbursed through international agencies, specialist NGOs, private contractors, et cetera. Does DfID or anyone else have the capacity to conduct due diligence on such organisations to ensure that value for money is not compromised?

Amyas Morse: Well, we have not looked specifically at fragile states. We did a study on fragile states in 2008 but since then we have not looked at DfID's capacity to work in fragile states. It may be that it is time we did so again. At that time we found that DfID at country level did not systematically assess the capacity of partners to deal with insecurity and we recommended a more consistent approach. As I mentioned earlier, the Department now has a different approach and is seeking to put more people on the ground in these territories. That is intended to give them a high degree of control and a better ability to directly assess the reliability of the partners that they have. The plan is that that programme will give them better control than they have ever had before. If they carry it through, we will obviously be able to see whether it works. It is bound to have some positive effect if they put skilled people on the ground. It is generally thought that a shift in the balance of resources from head office resource into deployed resource on the ground is probably a positive development.

Mark Andrews: Perhaps I might just add to that. For clarification, the report was on insecure environments—a subset of fragile states. We looked at a number of projects when we conducted that report in 2008. We found that in the majority of them there were issues around partner capacity to deliver on the ground in about two-thirds of the projects that we examined at that time. That was across a range of delivery partners. What DfID was doing at that time was seeking to strengthen the capacity of partners to deliver on the ground, including funding some capacity building. DfID was also trying to get more rigorous assessment of its ability to deliver in the field. Amyas is quite right. What is absolutely crucial is DfID's own ability to get staff out on the ground. It has faced some challenges in encouraging experienced advisers to work in the more insecure environments. As part of its recruitment of additional, particularly adviser, front-line staff and experts, one of the questions it now asks at recruitment stage is evidence of a willingness to work in those kinds of environments.

Lord Tugendhat: I can understand that. I see that if you are distributing money in Helmand province you will not necessarily have people whose principal interest is in accountancy and financial administration.

Mark Andrews: But the auditors go out to Helmand province, I can assure you.

Q385 The Chairman: Perhaps I may turn to multilateral agencies. There have been some criticisms from you and others on whether multilateral agencies are quite so assiduous in dealing with value for money, proper accounting, and so on. Almost 40% of DfID's budget goes to multilateral agencies. Are you confident that enough is being done to ensure that resources channelled through these agencies are being adequately accounted for and are generating the value for money to British taxpayers that you are encouraging us to get and are seeking through DfID?

Amyas Morse: Certainly, first of all, we had in mind a concern that given the growth in budget there might be an inappropriate growth in the amount of funding going to multilateral agencies. We raised that with DfID. They expect it to grow a certain amount but not to continue growing, and to be expended in a controlled and not unreasonable fashion. They have just conducted a multilateral review which should put them in the position to have a stronger grip and ability to assess the delivery through multilaterals and have much more due diligence than they have had in the past. We are going to carry out a detailed report on that next year and will say that, now the review is in and you are acting on it, we will assess whether or not it is working. That is as far as I can go at the moment. They have at least carried out a review, which as far as we can see addresses the right issues. In about a year's time we want to see whether it has been carried through and implemented effectively. I am sorry not to have that ready for the Committee now but we should be able to report more effectively.

Q386 Lord Levene of Portsoken: Whereas you might find DfID properly monitoring what the multilateral agencies are doing, have you seen any evidence that they are able to determine to what extent these agencies are not treading on each others' toes and to what extent there is duplication? Whereas the work of one agency may be fine, there are so many of them that it seems to me that there must be some duplication. Are they able to check that they are not paying different agencies to do exactly the same thing?

Amyas Morse: I shall ask my colleague Mark Andrews to say something but before I do, as I see it, most of these agencies—the ones with substantial funding capacity—are constantly working together. It is not as though they are unaware of what the others are doing. They constantly put different combinations together to support particular projects. While it does not mean that there is never duplication, they have probably been operating in this environment of multiple entities for quite some time, and have a reasonable awareness of who is involved and what they are likely to do on most occasions. Would you agree?

Mark Andrews: I think that is probably a reasonable assumption to make. The bottom line is that it is not something that we have looked at but we could well consider it as part of our forthcoming review. What DfID has done in carrying out its multilateral aid review—which is why we think it shows some promise in driving value for money—is to look at two axes in terms of their potential value for money. One is strategic fit. Some multilaterals, for example, lose out in the scoring on that because they operate in countries that are not priority countries for DfID. It has also looked at performance. Our understanding is that it has tried to do so on the basis of a fairly common set of criteria. That is something that we will test when we come to study this.

Q387 The Chairman: In this context, about half of multilateral aid goes through the European Commission. I understand that that was described in their context in terms of value for money as "only adequate". Have you looked at this and do you feel that there is more that the British Government should be doing to get greater value-for-money criteria applied to European aid? If not, should we be reducing the aid that goes through that means?

Mark Andrews: The short answer is that we have not looked at that. In terms of the proportion of multilaterals that are scored as adequate—yes, European Commission funding is a significant proportion of that. We have done some analysis for the International Development Committee where we have stripped out the fixed component of the European Commission to look at how funding increases range across the "good", "very good" and "adequate" categories. Once you take out that fixed element of expenditure, you can see quite a good correlation between DfID's ratings of the value for money of the multilaterals that it funds and how much it is prepared to give them in increases over the spending review period.

Q388 Lord Lawson of Blaby: It is a very serious point, is it not? Adequate is a different word for third-rate. You have "very good" first, "good" second and "adequate" third. This "third-rate" assessment applies not only to the European agency, which is part of the European Commission and the biggest in development, but to the United Nations agency. They both have that rating. As the Lord Chairman pointed out, these account for close to 40% of our total aid. Is this not a huge cause for concern?

Mark Andrews: Off the top of my head, I do not believe that all the UN agencies fall into that grouping, although some do.

Lord Lawson of Blaby: Most of them do.

Mark Andrews: That is a question that we need to look at when we study this.

Q389 Lord Forsyth of Drumlean: This is not meant to be a hostile question; it is a genuine query. If you are concerned with ensuring value for money, would you not start with the areas that are most likely not to provide for that? Was that not, on the face of it, how it was to be for our aid programme, with this 40% going to the multilateral agencies? Is that not where you should focus?

Amyas Morse: We are focusing on it next year. That is when we will look at it.

Lord Forsyth of Drumlean: My question was: why did you not start where there is likely to be most scope?

Amyas Morse: Because DfID has taken a step back and looked at how it influences agencies. We want to see whether they have applied aid effectively and then be in a position to assess that, rather than interpose ourselves before they do so. I think that that is quite sensible. Since we knew that these two reviews were being mooted, we thought it was better to see what their results were before making an assessment. We are not supposed to be looking at policy; we are supposed to be looking at efficiency, effectiveness and value for money. I would rather see what they do, assess it and then give our opinion.

Mark Andrews: If I could just add to that, the C&AG and the NAO cover all government expenditure. We spend a relatively small—or appropriate, rather—proportion of our value-for-money programme looking at DfID. That means we do only one or two full investigations a year. We have looked at the management of multilaterals, but that was back in 2005. That is why I prefer not to bring that evidence to the Committee; it is somewhat dated and precedes our time in post.

Q390 Lord Lawson of Blaby: In your report you point out that while DfID's total spend is expected to increase rapidly—the only part of government spending that is—administration is to be substantially cut by a third by 2013-14. Since it is in the administration that the value-for-money scrutiny rests, are you not slightly concerned by this?

Amyas Morse: I do not simply equate the size of the budget with the quality of administration.

Lord Lawson of Blaby: Who looks after the value for money if it is not the administration?

Amyas Morse: I raise two things. First, DfID is reducing central administration but, at the same time, as I have mentioned, there is an intention to have more people on the ground. Therefore, that has been budgeted for as well. As to the central administration, they are trying, appropriately, to raise the quality and have a rather more modern and system-based approach. Are there risks associated with it? Yes, there are. Is it unfeasible to reduce costs of the central administration and, none the less, have good control over this programme as it develops? Evidently, there is an execution risk but it is not necessarily a contradiction.

Lord Lawson of Blaby: What are the execution risks?

Amyas Morse: The execution risks are that DfID does not get the people on the ground and does not manage to recruit the requisite number of quality people into the centre. If it is trying to have a smaller and more skilful centre, there are obviously some risks associated with both that and having the right people on the ground to control where the aid is being delivered more effectively.

Mark Andrews: If I might add to that, even though DfID is seeking to take a third out of its administrative costs, there are particular areas and capabilities that it is seeking to grow. For example, it is seeking a modest rise in the number of finance professionals that it recruits and deploys in the business. The other key point is that value for money should not just be for head office. It absolutely needs to be integrated out on the ground among the front-line staff. These quite significant rises in the front-line staff that DfID is recruiting include economists, value-for-money and results advisers and so on. They will be embedded in the country teams.

Q391 Lord Levene of Portsoken: The problem of fraud and corruption features quite heavily in your report and in that of the PAC. In particular concerns are expressed that declared levels of fraud are implausibly low, suggesting a reluctant reactive approach to detection by DfID. Given what is to be fair the relative lack of financial expertise in the department and the pressure on the administrative budget, what can and should DfID do to improve the detection and recovery of fraud?

Amyas Morse: In answering you I will repeat some of what I said earlier. I hope you will excuse me for that. First, once a fraud is known, DfID's record on investigating it is good.

Lord Levene of Portsoken: But you have to find it first.

Amyas Morse: Exactly, and that is why I shall go back to the view I gave you earlier. I think its approach should be a much more methodical quantification of the risk of fraud and one of driving prevention activity off that: first, taking account of which territory it is investing in and what means it will use to deliver aid; and, secondly, driving its fraud prevention efforts by an assessment of territory risk.

Q392 Lord Levene of Portsoken: So the main task of DfID is not to look for fraud in the money that is being spent. Nevertheless, the Department spends a lot of money. How is this done? Does a specialised group do it or should the Department go out and get someone else to do it?

Amyas Morse: The Department is assisted in doing this by having its own aid fraud watchdog, which has been set up. I believe that you will be taking evidence from that group, the Independent Commission for Aid Impact, in the new year. I think that that will inject a much more rigorous and consistent approach. I know that the group is doing a lot of examinations at a much higher volume than that which we can devote just to the fraud aspects, so that is genuinely quite a significant change of atmosphere. We are working closely with the group and I am confident that, when you hear from them, you will find that they are taking a very clear and rigorous approach.

Q393 Lord Levene of Portsoken: You look at all government departments. Do you think that the instance of fraud that may be coming out of DfID is comparable with other departments or is it much greater?

Amyas Morse: Do I think it is comparable with other departments? I think it is significantly different in that the exposure to fraud is so much greater. I do not think it is particularly comparable, to be quite honest with you, because it is almost inherent. What we would describe as fraud is not necessarily even recognised as such. We are used to operating primarily in the UK where a high level of fiscal morality is available so that, generally speaking, if someone is carrying out a fraud they know they are doing something wrong, whereas in a lot of these territories it is not even culturally necessarily in that category. That makes it a lot more difficult to deal with. I am not excusing it; I am simply stating the fact that this is a much bumpier playing field.

Lord Levene of Portsoken: But in the evidence there is a note which states that DfID had reportedly identified fraudulent activity as only 0.01% of its budget. That is just not plausible, is it?

Amyas Morse: No, we do not think it is plausible, and we think that a more appropriate approach is one which makes certain assumptions about the environment. It says, "If this is the environment, it is likely that, based on experience, a fraud of a high level is taking place and we will base our investigative approach on that." I can understand, frankly, why DfID is not very keen to talk about fraud in its programme because it probably thinks that that is quite damaging to the Government's willingness to support aid programmes, but we do not recommend that that should continue. We think that a more rigorous approach is appropriate.

Q394 Lord Lawson of Blaby: That is very important because the DfID estimate quoted by Lord Levene is clearly nonsense and much too small. This is a matter of great concern to you. What is your best estimate?

Amyas Morse: We do not have one. Short of doing a territory examination of the sort I described to you earlier, I do not have a basis for making such an estimate. Although we use extrapolated figures in our work across government, including on fraud and error in some cases, we start with samples and so forth to enable us to do that. We are not in a position to have that sort of information on such a broad range across so many territories.

Q395 Lord Levene of Portsoken: You said, I am sure quite rightly, that the nature of the Department's business makes it inherently much more exposed to fraud, because that is the way it is. Is the Department, in your opinion, committing enough resources? No department wants to say, "I am going to put all my resources into looking for fraud," but unfortunately that is the nature of the beast here. Are enough resources being put into at least monitoring in order to try to prevent fraud? If it is just comparable with any other department, it is going to be way behind the curve.

Amyas Morse: I genuinely think that there has been a significant change since—forgive me for saying this—the change of Government and the new Permanent Secretary and Minister involved. What we hear are very firm signals, and it is only fair to reflect those back. Obviously, if we find that they are not being carried through properly, that would be something else, but we are quite encouraged by the intent that we are seeing and by the actions that have been taken: setting up a separate body to put pressure on this is good. Quite a lot of actions are being taken and they are ones that I think should lead us in the right direction. If we find that they are not being followed, we will criticise that trenchantly.
Lord Levene of Portsoken: So far the right noises are being made, but you want to wait and see what the results are.

Amyas Morse: Yes. It is a little bit more than noise, but it is certainly not at the point where you could say that the problem is really under control. We would not pretend that.

Q396 Lord Forsyth of Drumlean: Perhaps I can tack on to the last part of that. You said two things in your previous answers which have rather alarmed me. One was that you can quite understand why DfID would want to minimise the exposure of fraud because that would make it more difficult for the Department to—I am now putting words into your mouth, but you implied that that would make it more difficult for it to justify its programmes and that that would create political difficulties for it. When you say that since the change of Government and the new Permanent Secretary there has been a change of culture, does that change of culture involve not taking that attitude, which would be quite wrong?

Amyas Morse: Yes, I think it does. I am trying not to impute an attitude to any particular Government, but I would say that we see a rigorous approach now. My comment is simply that if there is anything about fraud in aid programmes, it tends to get an awful lot of press. I am simply showing a certain understanding of that but not implying that it gives rise to some sort of permissive attitude.

Lord Forsyth of Drumlean: No, I am not suggesting that you are. But there are two facts, are there not? The first is that the Department thinks the fraud was 0.01% of its budget.

Amyas Morse: Yes, which is probably what I would call detected fraud.

Lord Forsyth of Drumlean: Secondly, the Department is the only arm of government that has actually had an increase in its budget, which is a matter of some controversy. In the past, the attitude has been, as you indicated, that it might not want too much exposure to fraud because that would damage its budget. If you put these two things together, that makes me think that there is not really going to be very much incentive, even if there has been a change of Government, to change that. Therefore, should there not be some kind of external pressure looking at this, like yourselves?

Amyas Morse: We will be looking at it and I do not consider my remarks to be an assessment of previous conduct; they are simply an understanding of what possible motivation there was. Possibly that was an unwise thing for me to say, but nevertheless that is what I meant. However, the Department has set up an independent audit body focused on looking at aid programmes and fraud in aid programmes. That body is professionally staffed. It is not enormous, but it is focused exclusively on that area. I think that that is quite a sincere intent. You will have a chance to examine the body, and I understand that its first report will be coming out quite early in the new year. In addition to our attention to this, you will have a chance to see whether that does not beef things up. I think it will.

The Chairman: Can we move on?

Q397 Lord Forsyth of Drumlean: Given the weakness that the NAO and the PAC identified, what are the main financial risks that you see associated with the expansion of DfID's budget, and at the same time the shift in emphasis that the Department is making towards greater engagement with fragile states?

Amyas Morse: The risks are the ones that I have indicated. If there was a rapid increase in spending and that came into the budget over a fairly short period of time, could that be absorbed efficiently and in a controlled way, particularly if that increase in spending was combined with spending in fewer countries and focusing on riskier countries, as well as moving into new sectors? Each one of those is a potential additional risk factor. None of that is to say that those are wrong directions to go in, but they simply, and as a matter of fact all, indicate potential risk. So what all of that tells me is that the rate of improvement required in the control environment in DfID is quite a steep climb. I have already given you my opinion that it is not impossible for DfID to do this, but it is challenging and it will need to be watched very closely as to whether it is succeeding or not.

Q398 Lord Best: You may feel that you have answered this sufficiently because you said earlier that it is not the role of the NAO to comment on government policy, but can you express a view on whether the Government should implement their intention to make it a legal obligation that the UK commits to reach the international target of 0.7% of GNP on aid?

Amyas Morse: I would ask to be excused from that. I am expressly enjoined not to give views on policy.

Lord Best: I thought you might say that.

The Chairman: Mr Morse and Mr Andrews, I think it would be fair to say that we were much struck by the hard-hitting reports by the NAO and the PAC, but that has not been completely reflected in the answers we have received today. I suspect that it is also because, as you indicated and said explicitly at one point, you have been encouraged by the intent of the new Government and the actions that have been taken. I suspect that that is why you have pulled back a bit. Nevertheless, you have made some harsh criticisms of DfID in the past. I was pleased to hear you say that if the new intent and actions were not followed, you would criticise it intensely, so we would expect you to be monitoring it carefully. I think that I am right in my assessment of the way in which you have appeared before us today. Thank you very much indeed for coming. I still feel that your report is extremely valuable and I hope that you will continue actively to pursue the way in which DfID carries through its new actions.

National Audit Office—Supplementary written evidence

To: The Committee Assistant

Thank you for the opportunity to suggest alterations to the draft transcript of the evidence session on 15 November.

The enclosed document reflects corrections suggested by both the Comptroller and Auditor General and Mark Andrews.

Both witnesses referred to published NAO reports in their answers. We thought it might be helpful for the Clerk if we listed the relevant sections of our reports in an Annex to this letter.

29 November 2011

Annex: NAO Reports referred to during the evidence session on 15 November 2011

Lords EAC question and general issue	NAO Report	Point made in NAO report	Relevant section of NAO report
Q370, Q380 Criteria and measures for assessing VFM	DFID: Bilateral Support to Primary Education[315]	In 2010 DFID was focused on inputs (e.g. numbers of teachers) rather than outputs (e.g. educational attainment)	Paras 5-9, 15-17
Q371 DFID's attention to economic development	DFID: Bilateral Support to Primary Education	An additional year of education in developing countries can add significantly to wage-earning potential	Paras 7, 15, 2.13
Q371 DFID's attention to economic development	DFID: Transferring cash and assets to the poor[316]	DFID has focused on sustainability rather than simply providing handouts. DFID has considered both the longer-term impacts of transfer programmes on beneficiaries and has given attention to long term sustainability of the programmes themselves	Longer-term impacts on beneficiaries paras 7, 3.3-3.7 Sustainability of programmes paras 12-14, Part 4
Q375 DFID's approach to handling risk	DFID: Transferring cash and assets to the poor	DFID can and should be innovative in managing risk. For example, electronic payment can be a more efficient and reliable method for	Paras 6, 16c, 2.13

[315] http://www.nao.org.uk/publications/1011/dfid_support_to_education.aspx
[316] http://www.nao.org.uk/publications/1012/dfid_transferring_cash.aspx

Lords EAC question and general issue	**NAO Report**	**Point made in NAO report**	**Relevant section of NAO report**
		delivering transfers to isolated populations and has been used by DFID in Kenya	
Q381 Risks of different forms of aid	DFID: Transferring cash and assets to the poor	DFID typically operates through a delivery chain. Although the transfer programmes funded by DFID use shorter and more transparent delivery chains than other aid approaches, DFID still operates through an NGO, the Government, the private sector or a combination of partners.	Para 1, Figures 1 and 3
Q384 DFID's capacity to conduct due diligence on partners	DFID: Operating in insecure environments[317]	In 2008, DFID did not systematically assess the strengths and weaknesses of its partners in insecure environments. We found that there were issues of partner capacity in two-thirds of projects we examined in 2008. DFID was seeking to strengthen capacity of some partners.	Paras 7, 10c, 1.17, 2.6-2.11
Q372, Q384, Q390 DFID's capacity to secure VFM and undertake due diligence of partners. The impact of cuts in DFID's administration costs on VFM.	Briefing to support International Development Committee's inquiry into DFID's Annual Report and Accounts 2010-11 and Business Plan 2011-15[318]	Briefing explains how DFID plans to deliver its administration savings and at the same time increase its front-line capacity; including the number of advisers it employs (i.e. experts in sectors such as governance and security).	Part 3 sets out how the Department plans to reduce in its administration costs. Para 3.4 explains that DFID has the financial flexibility to increase its front-line staff. Part 4 explains how DFID plans to restructure its workforce.
Q387 VFM of DFID's funding of multilaterals	Briefing for IDC	The largest planned funding increases over the Spending Review period will go to those multilaterals rated as very good or good by the Department under the MAR	Paras 2.9-2.10, Figure 9

[317] http://www.nao.org.uk/publications/0708/operating_in_insecure_environm.aspx
[318] http://www.nao.org.uk/publications/1012/dfid_annual_report.aspx

Lords EAC question and general issue	NAO Report	Point made in NAO report	Relevant section of NAO report

Professor Benno Ndulu and Professor Robert Picciotto—Oral evidence (QQ 31-50)

Evidence Session No. 2. Heard in Public. Questions 31 - 50

TUESDAY 28 JUNE 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Forsyth of Drumlean
Baroness Kingsmill
Lord Lawson of Blaby
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Professor Benno Ndulu, [Governor, Bank of Tanzania], and **Professor Robert Picciotto**, [King's College London].

Q399 The Chairman: Good afternoon. I warmly welcome our two very distinguished witnesses this afternoon, Professor Ndulu—Governor Ndulu, in fact—and Professor Picciotto. We are very grateful to you for coming. I have to make one or two formal announcements. Copies of Members' entries in the Register of Interests are available. I would be grateful if you would speak loud and clear for the webcast and for the transcript. We will be asking questions to you both, but you do not have to answer all the questions. If you agree with the first answer that was given, in the interests of time just say that you agree. We hope to finish at 4.50. I am going to ask the first question. What role is played by development aid, and by foreign aid donors, in the development and implementation of economic policy in recipient countries such as Tanzania? Has aid contributed to enhanced growth and poverty reduction, or hindered it?

Professor Benno Ndulu: Thank you, Lord Chairman. Aid has provided support to our development initiatives through two channels. One, which is typically recognised directly, is to reduce the financing gaps that we have to run various programmes. The other is to enhance or support policy reforms, which have been a very important and integral part of the aid programme. As far as Tanzania is concerned, it is very clear that aid has had a very significant impact in the areas where it was targeted and when it was applied in conjunction with the Government budget. I can give a few examples. The policy reforms have typically helped Tanzania to ramp up its growth performance very significantly. Over the last 10 years, Tanzania grew at around 7%. This is a very respectable growth compared to the period prior to the application of reforms, when the country's growth rate averaged around 3% in the decade before that, and even negative growth in per capita terms in the 1980s. So there was a very significant change in terms of the growth process.

But more important is the achievement in the priority areas where most of the aid was directed: education, health and water. Those three sectors together accounted for more than one third of the Government budget as well as one third of the aid resources. I am happy to report definitely that all of the MDG targets that Tanzania has either achieved already by mid-point, or is on track to achieve, or is likely to achieve, are in these three sectors. Primary school enrolment and gender equality in primary education has already been achieved by mid-point. On track is HIV prevalence as well as access to potable water. Likely to be achieved are infant mortality and under-five mortality. All these are in sectors where most of the aid resources went. Where we were least able to achieve is in the areas where most of the resources did not go but will now go. That is on the income poverty side as well as food security. One statement I can make is that the rate of improvement of pace towards MDGs has more than tripled since 2000, with the reform agenda as well as aid. I have a very positive view of what has happened in the areas where the resources went.

Professor Robert Picciotto: I very much agree with my friend and colleague. Development aid has been one of the most influential ideas in economic history. It is a relatively new idea since it emerged after the Second World War, when the concept of helping people in faraway lands took off. Aid itself has always been fuelled by ideas. The impact of aid on economic policy shows remarkable diversity and rapid evolution. First there was a sense that Governments had to be at the commanding heights of the economy. Import substitution and heavy public investments were viewed as engines of economic progress. When I joined the World Bank in 1961 we were promoting central planning offices and industrial development corporations. The debt crisis of the 1980s changed the paradigm. That is when the Washington consensus came in and put markets at the centre of development assistance.

After the implosion of the Soviet Union the project of global economic integration was supported by development assistance: aid was put at the service of globalisation. This is the so-called adjustment era. Some success stories were associated with this period of development assistance e.g. Bangladesh and Turkey were helped by the outward reorientation of economic policies. But this approach had a downside in fragile countries (e.g. on Africa) that did not have the market institutions to manage the process. East Asia was remarkably successful in picking up the ideas of development economists and adapting them to the local context. They focused on connecting their economies to the engine of the global market, but also invested heavily in human capital creation and agriculture.

The downside of adjustment and the debt crisis created a backlash, so it came to pass that the United Nations holistic approach to development became more prominent. That was a remarkable triumph of development diplomacy in getting the Millennium Development Goals agreed by all United Nations members. Before the Millennium Development Goals were unveiled there were different views about what development was about. The MDGs managed to bring about universal consensus about how development should be judged. This is where we are now.

You asked whether aid has helped or hurt development. It is important to distinguish between whether development has worked and whether aid has contributed to it. Those are two separate questions. Development is a remarkable success. It took the United Kingdom 60 years to double output per person. Turkey did it in 20 years, Brazil in 18 years and China and Korea in 10 years. So development has been a major success, fuelled by growth. Equally social indicators have recorded major gains. Just as one example, life expectancy rose from 55 years in 1970 to 69 years in 2008. Tanzania is going to meet most of the MDGs and the world as a whole is on track to meet at least one of the targets, which is that the poverty rate (46% in 1990), should be cut in half by 2015. This is likely to happen. But most indicators are not going to be met by a majority of countries and there will still be 920 million people living under the international poverty line of $1.25 a day, as redefined by the World Bank in 2008.

Of course, aid is only one of the contributing factors. There has been a cottage industry of studies that aimed to figure out how much aid helped in development. The results are fairly clear. Paul Collier has estimated that aid has added one percentage point to the annual growth rate of poor countries as a whole. At the level of individual aid operations, there is strong evaluation evidence that at least two thirds of projects have succeeded. One has to keep in mind that development is a risky enterprise. You get high payouts, but you also have to incur high risks. One of the problems is that very often politicians expect a much higher rate of success in aid than in domestic programmes, which leads to risk aversion. One has to accept that development aid requires taking risks.

Q400 Baroness Kingsmill: Thank you for being with us today. I spent a very enjoyable holiday earlier this year in Tanzania. It is a delightful country. How do you see the role of the official development assistance committee aid, including UK aid, evolving in Tanzania and other recipient countries over the coming decade?

Professor Benno Ndulu: I see the evolution in four main areas. First is greater support for enhancing and scaling up growth, and particularly growth in sectors that support the majority of the poor, which is agriculture and small and medium-scale enterprise. There is no doubt that these are the two areas where Tanzania has lagged behind most in meeting its MDGs. Much as growth has averaged 7%, the rate of reduction of income poverty has been not as large. Growth has contributed a lot more through generation of revenue to finance public expenditure in education, health and water, as I have indicated. Sometimes we forget that growth has this role. In fact, over the period 2000-2010, revenue generation has increased more than sevenfold in Tanzania. About 59% of that growth in revenue is accounted for by growth of the income itself as a base. A respectable 41% is due to a rise in tax effort. We have seen an increase in tax-to-GDP ratio from 10% to almost 16% within this period. So I think supporting growth is key.

Also, in the second dimension, which is sustaining the achievement in the social areas of education, health and water, part of this is that as school enrolment has increased and coverage of health has increased, the recurrent budget has grown very rapidly, because we have to hire more teachers and doctors and provide more medicine and related things. Most of this has to be funded through domestic revenue. Unless we really ramp up growth and revenue generation, we may see a repeat of what happened in the late 1970s and early 1980s in a number of countries, when there were big drives towards literacy and health and significant achievements, for that matter. Tanzania had already achieved almost 90% literacy in the early 1980s, but then it all collapsed for lack of maintenance and operating budgets, and part of the reason was that growth did not happen alongside this drive in investment. It is very important, even for sustainability of the achievements, that I mention a shift towards supporting growth in infrastructure, agriculture and service.

The third area where I see evolution is that the needs for financing are huge. The infrastructure financing gap is very large. For example, for Tanzania's medium-term plan for the next five years there is an estimate of $10 billion dollars required on infrastructure. There is no way in which Government and its partners will be able to fill such a gap. There will be a need for involving private investment and private finance. To the extent that both aid and Government can leverage private resources, then we would have a real chance to implement those programmes. Therefore, probably leveraging through private-public partnerships and through guarantee schemes as well as underwriting other forms of risk would add to the total resource envelope that would be available for these purposes.

Finally, I think a very clear sense and commitment is there to reduce aid dependency over time. In the medium-term plan that was recently approved in Parliament, there is a target that the country has set to reduce significantly that extent of dependency through increasing domestic revenue to a very large extent and finding other forms of financing that draw on the involvement of the private sector in some of the areas where the Government are now doing it alone.

Q401 Baroness Kingsmill: Would you say, therefore, that political stability and a commitment to a relatively market-based economic policy facilitate donor countries in being able to be innovative in their aid giving and in innovative programmes that you would introduce in Tanzania?

Professor Benno Ndulu: Absolutely important and critical. Political stability and retaining peace will be critical for that continuation and will open doors to private finance. Without those, it cannot happen. Not only that, it is also true for countries that have been in conflict previously. We have seen a huge impact of the peace dividend that results in much more progress besides simply the attraction of additional resources.

Professor Robert Picciotto: May I add that how the UK development policy develops is critical for the global aid effort? The UK is widely perceived as a leader in development assistance. With $13.5 billion dollars worth of development assistance, it ranks just below the United States—in terms of volume, obviously. The UK also ranks high in terms of aid quality. How the UK looks at development assistance has great influence for the total development community.

That said, the importance of aid in development in relative terms is declining. Development co-operation goes beyond aid. The value of exports from developing countries is more than 40 times the level of official aid flows. Remittances for migrants are about three times as large as aid flows. Private capital inflows are 10 times aid flows, and so on. Environmental policies, where the UK also enjoys a relatively good record, have a negative impact on climate change that mostly hurts developing countries.

Having joined-up Government in how all Departments approach development cooperation is as important as DfID's own role. Therefore, leveraging aid by influencing these other transmission belts of globalisation in a way that is market-friendly and people friendly remains critical, as we have just heard, so as to promote equitable growth in developing countries.

Q402 Lord Lipsey: I was brought up in the era, fortunately now past, when development aid was often described as if it was the new form of imperialism. Without wanting to go down that road, there are still issues about the ownership of aid and whether countries that accept aid are also accepting too much outside control with that and are not really owning the aid they are getting. How far is that a problem for Tanzania and, indeed, more generally?

Professor Benno Ndulu: I will speak more explicitly about Tanzania, briefly. Ownership of aid really depends to a very large extent on the modality in which it is the delivered. There are two forms that have made a big difference in terms of Government ownership and participation of local constituencies. The ownership is not just for the Government. We think we have made strides in looking at accountability to the public more generally. It is not simply the Government itself. These two forms are budget support and basket funding, partly because they tend to operate within the framework of the budget and which in turn is the instrument that is subject to review and discussion by the public and by Parliament. Other forms may not be. In terms of narrow accountability and ownership and the broader accountability and ownership, those two forms certainly open the doors to making sure that the country priorities and resources are used in conjunction with aid.

Tanzania has made very significant progress in this area. These two modalities together—budget support and basket funding—at their peak accounted for almost 62% of all aid that was being delivered to Tanzania. What we call project funds accounted for about 37%. To some extent, project funds are much less amenable to co-ordination and to Government prioritisation in the manner that budget support and basket funds would be.

The UK is also a leader in Tanzania in this respect. In 2008-09 at the peak, out of its total general support to Tanzania, 90% was disbursed through general budget support, 8% through basket funds and only 2% as direct project support. Starting with the point that these are the modalities most amenable to Government leadership and co-ordination, the United Kingdom was definitely a very clear leader within this. What the UK does in Tanzania still accounts for what generally would tend to be driving the rest in the forms and attitude towards support.

Professor Robert Picciotto: The issue of ownership was laid to rest when the Paris Declaration was signed by all countries providing aid. It asserts that developing countries set their own strategies for poverty reduction and have primary responsibility for improving their institutions and tackling corruption. The Paris Declaration principles are also embedded in the Millennium Development Goals, a significant shift from the adjustment era, when economic conditionality was highly visible.

That said, problems arise in fragile states where ownership is difficult to define and Governments may not be representative. In such cases, ownership must embrace not only with Government, but the civil society and the private sector. So, while everybody agrees with the concept of ownership, applying it in practice is demanding in countries that are weak and fragile.

Q403 The Chairman: Would there be any conditions in which you would turn down aid?

Professor Benno Ndulu: Certainly, aid that would to a very significant extent entail compromising on the moral principles of the country would be among that group. It has happened. Where, let us say, undue pressure or influence of specific interests are clearly driving the generous giving, we would hesitate to receive such support. I am being a little bit cryptic on this, because it rarely happens, but it does happen from time to time.

Q404 The Chairman: And that includes commercial exploitation and things of that sort, does it?

Professor Benno Ndulu: Yes. I was partly hesitating, but that is partly exactly the reason.

Q405 Lord Tugendhat: The millennium development objectives and the objective of infrastructure investment sometimes seem to run across each other. In your experience in Tanzania, do you feel that you are able to devote the emphasis to infrastructure investment that you would wish, or is this being diluted to some extent by the Millennium Development Goals?

Professor Benno Ndulu: The Millennium Development Goals include areas that are important for reducing income poverty as well as food insecurity. Therefore, all expenditures that support investment in infrastructure, which is supporting growth, are also important for at least addressing the two areas where I feel that Tanzania is still lagging, which are income poverty and food security, although the food security side has improved very rapidly more recently.

But again, as I have indicated, the sustainability of achievements under the MDGs cannot be guaranteed without increasing the ability of the country to pay for recurrent costs and budgets. That requires that domestic revenue mobilisation increases, and that depends to a very large extent on growth. These two sides are supposed to be complementary, but Tanzania began with a bigger drive on the MDGs other than income poverty. Therefore, it was health, education and water that received the first emphasis, but very quickly now we have seen that there is no way you can sustain those without raising your ability to pay for sustaining these particular achievements. These two ought to go together and we are rebalancing in that respect as more and more resources are going to infrastructure now. In the budget this year, infrastructure alone almost takes up one third. That is a quantum shift from the previous three or four years, partly to address exactly that issue of sustainability and achieving improvements on income poverty.

Professor Robert Picciotto: May I add that the Millennium Goals do not prescribe the means of achieving those goals? It was always understood when the goals were endorsed that case-by-case poverty reduction strategies designed by developing country Governments, in consultation with the private sector and the civil society, would provide the framework for aid. The MDGs are therefore not a guide to inter-sectoral aid allocations. That said, it is a fact that over the past 15 years or so there has been a severe drop in investment in agriculture and infrastructure. It is time to reverse that trend and to put more emphasis on these two sectors, which, as we have just heard, are very relevant to the main goal of poverty reduction. Infrastructure development is demanding, though, because it involves a significant amount of corruption in some countries and brings up social issues, such as resettlement, indigenous people's rights etc, that need safeguard policies. Development when well managed can minimise those social risks. But it is not a panacea simply to invest in those sectors; it has to be done intelligently.

Q406 Lord Shipley: Can I ask Professor Ndulu about budget support? I think you said earlier that 90% of aid in Tanzania came in the form of budget support. What are the differences in a domestic political sense between the different forms of aid, from general budget support through budget aid to technical assistance? Do those different aid modalities impact on domestic political conditions differently?

Professor Benno Ndulu: The budget support overall in Tanzania at the peak accounted for about 42% of total aid, but 90% of UK aid was delivered through budget support. That modality has very strong virtues politically with regard to accountability. As long as prioritisation and accountability for the application of the resources are subjected to democratic processes, particularly review by Parliament, which represents the interests and the will of the broader population, that aid has to be delivered through the budget and has to be on budget. Then it becomes subject to that form of accountability. It is also true that project aid is delivered sometimes on budget, but not all of it. There is direct disbursement. The same is true of technical assistance. There is a lot of it in what we call direct funds. They are seen only after the event, and you have to take a record that these have been spent on your behalf. In terms of ex ante accountability politically, basket funds and budget support are much more amenable to this scrutiny, which is always important in ensuring that there is accountability.

An instrument that used to be even more robust in the past than now is the public expenditure review process, which is not just an accountability instrument but an instrument that helps to ensure that there is value for money and that money is spent for the purpose. Again, support provided through general budget support is much more amenable to that process.

The reform agenda linked to budget support is very much country-owned. The way that one does that is by moving away from the former IMF conditionality approach to internalising the reform agenda as part of the budget process. The donors and the Government sit on the same platform to decide on priorities, and they sit on the same side in terms of accountability for budget execution. There is no doubt that if one wants really to support the development of democracy and accountability to the local constituency, there has to be a modality that subjects consideration to budget processes. In my view, that would be the strongest point regarding accountability.

Q407 The Chairman: Could you explain a little more exactly what the process is for public accountability in terms of value for money? I understand accountability and audit in terms of funds being expended correctly, but how about for value for money?

Professor Benno Ndulu: In terms of value for money, government projects that are now subject to budget processes have to be audited by the Comptroller and Auditor General, and one aspect of his portfolio is to establish value for money. It is not simply about whether money was used for the purpose; it is about what actually was achieved from it. This has been expanded in terms of coverage. There was initially purely expenditure tracking to make sure that money was used for the purpose, but in addition to that there is now accountability for results. The parliamentary committees to which the Comptroller and Auditor General gives his reports have now placed much more emphasis on going beyond whether the money was spent for the purpose; they now demand whether or not schools or hospitals were built as per value or whether medical supplies were delivered. The committees now go around in various localities and take stock of this. That phenomenon has grown in the past three years. It is a very important phenomenon, but it can be done only for money that is being channelled through the budget.

Professor Robert Picciotto: Not all countries are fortunate enough to have fiduciary systems in place. Tanzania is one of the well managed economies of the developing world. Budget support has an extremely important role to play in countries where such systems are in place but, when they are not in place, budget support is quite risky and can be addictive as well. The advantage of budget support aid is that it minimises transaction costs, facilitates co-ordination among donors and puts countries in the driver's seat. But it takes a long time for countries to reach that level, and in that context project lending or sector lending can help to make countries safe for budget support lending by becoming vehicles for institution-building and ensuring that, at least at the project level, the proper fiduciary systems are in place along with the proper evaluation systems to assess value for money. Gradually these reforms can spread from the project to the sector to the country as a whole. Budget support is therefore one of the important tools in the toolbox of development assistance, but project lending can also be very useful.

Q408 Lord Smith of Clifton: Professor Ndulu, has there been any feedback on these value-for-money measures, the expansion of the Comptroller and Auditor-General's role and the parliamentary committees looking at various projects on the ground? Has there been any feedback that you could give us examples of to point out failures in the system?

Professor Benno Ndulu: There has been feedback. Feedback is also made very public. It has recently played a major role in opening up accountability to the local populations and providing additional information. Some projects were clearly not delivering what was required. The cases cited most frequently to the committees that travelled around, particularly the local government committees, involved the quality of schools that were built; they were clearly not on a par with the money spent, and the audit showed clearly that the product was not worth what had been spent. The officials concerned have increasingly been brought to book since these accountability committees started on the ground scrutiny meeting. Actually, all these committees in Tanzania are led by the Opposition, not the Government; they have tended to be much more active that way.

Q409 Lord Smith of Clifton: Thank you very much. I now want to turn to the efficiency and competitiveness of the economy. Asia is often said to have generated "Dutch disease" effects. Are these common? Is this a risk in Tanzania? What impact have aid flows had on private sector performance? In particular, to what extent might they have inhibited Tanzania's export performance?

Professor Benno Ndulu: In Tanzania's case, all the evidence that exists clearly shows that Dutch disease has not been part of the consequences of aid, partly because to a large extent they have been sterilized because a significant part of aid is used to import what is needed and that leaves the exchange rate unaffected. For example, where it is being used for financing education and other things that are non-traded, the central bank has appropriately sold some of the Forex in order to withdraw some of the liquidity that is being injected that way. By and large, when you look at Tanzania's exchange rate, it has not lost its competitiveness. In fact, a recent IMF review has shown that, if anything, the Tanzania exchange rate has remained quite competitive and has not appreciated at all. There is even stronger evidence in the export performance, which has continued to grow at almost 22% annually. We have also seen a very significant diversification of exports in areas that are not of the mineral type, including manufacturing, which has become the number three foreign exchange earner for the country from being way down the list. There are no signs of the disease.

Professor Robert Picciotto: There are very few countries where aid is so voluminous as to create Dutch disease. It occurs mostly in countries that are oil producers or primary commodity producers that rely exclusively on this source of wealth to manage their economies. Furthermore, as Professor Ndulu has just mentioned, Dutch disease can be cured through good macroeconomic management, even if the economy is natural resource-based. Take the case of Chile; it was able to capture copper export revenues in special funds when the copper price was high, very much as Norway has done for oil. The Dutch disease issue needs to be put in context, and should be addressed mostly in countries that are not managing their economies properly and are highly dependent on natural resource exports or receive excessive capital inflows that they do not manage properly.

The other dimension of Dutch disease is that it breaks the social contract. In other words, if Governments are highly aid dependent and spend most of their time satisfying donors instead of their own citizens, that can be a problem. High aid dependency is an issue as Professor Ndulu has stressed. Eventually domestic resource mobilisation should replace aid.

Q410 Lord Moonie: How can aid be configured to give better support to private investment, growth and employment in Tanzania and indeed in aid recipient countries in general?

Professor Benno Ndulu: Aid can play a very powerful role in helping to mobilise resources beyond a country's own, particularly in supporting recipient countries' access to international markets. I will give an example: recently, as part of the financing of a power project—we are very short of power as a country—Tanzania was looking at non-concessional borrowing. Fortunately, there were public agencies from the contracting country that were ready to underwrite the loan by providing guarantees to have access to that loan. That helped not only to make sure that the loan was available but also that it was at a lower cost because it reduced the risk premium. Likewise, through multilateral agencies, loan syndications have been done where such multilateral agencies, like the Asian Development Bank and the World Bank, have been able to more or less take a lead in mobilising finance for particular infrastructure investment. More important is the support that we have started getting in implementing public/private partnership projects, where support from donors would help the Government to underwrite some financial resources. Big projects have been built with PPP along those lines. The South Africa-Mozambique highway was financed that way, and other highways are in the pipeline. We are in the process of putting in place more than 200 megawatts power plant through arrangements of that kind. This is new in terms of areas that have come into play, but it is a very effective way of supporting private investment.

The other form has been the reform agenda, particularly in terms of supporting the improvement of the business environment. That has been part of the dialogue and it has helped to open doors. It is still a big challenge to get to perfection, but that reform agenda and the dialogue have also been helpful.

With regard to jobs, which are very important, recent greater support for agriculture and small and medium-scale enterprises will make a big difference. Unfortunately, I must say that agriculture and SMEs have not been top of the agenda for most aid; it has been more in education, health and water. However, it is clear now that without making inroads into a sector like agriculture that provides livelihoods for more than 75% of the population, although it accounts for only 28% of GDP, not only will poverty be hard to eradicate but instability will be a big problem as jobs become scarce. Youth unemployment in particular is a time bomb that we are all very clear about, and we need to fix that if this process of development is not to be interrupted.

The Chairman: I am conscious of the time, so we will have to move on a little.

Professor Robert Picciotto: Aid for trade can be very helpful to the private sector. The rule of law and property rights through advice can help. Aid can also impact directly on the private sector through investments in companies and providing credit to small, medium and micro enterprises.

Q411 Lord Forsyth of Drumlean: Professors, you have both laid emphasis on the importance of evaluation. What is required in terms of how evaluation is implemented, and how are the results of evaluations used, to ensure that donors do not end up supporting only those activities that can be easily evaluated?

Professor Robert Picciotto: I spent 10 years running the Independent Evaluation Group at the World Bank. I have learnt, along with my colleagues in aid agencies, that the independence of evaluation is fundamental. This country has now set up a totally independent aid watchdog reporting to Parliament, the first in the development system. Another determinant of evaluation quality is getting the right skills and promoting training in evaluation, which is still very limited. Evaluation is not research or auditing; it is a discipline in its own right.

The other aspect of evaluation is the connection between independent evaluation and self-evaluation. In other words, evaluation produces good results if it is embedded in the business processes. If individual projects or aid intervention more generally do not have evaluation built into them, there is no feedback mechanism to improve the overall process. Just as auditing oversees accounting, independent evaluation should oversee self-evaluation. In the system that has just been established in the United Kingdom, it is that linkage between the aid watchdog and DfID's own evaluation system that needs to be watched.

Q412 The Chairman: Professor, I know that you have done a lot of work on this over many years. You have been able to answer only very briefly on this subject. It would be helpful to the Committee if you could do us a note developing some of the themes that you have mentioned, particularly how you think that the new UK initiative is on the right lines.

Professor Robert Picciotto: I would be delighted to do so. I serve on the boards of the UK Evaluation Society and the European Evaluation Society. Our profession is very much an infant industry so it needs to be promoted.

The Chairman: It is very much at the heart of some of the work that we are doing on this Committee, so it would be helpful to have your note.

Q413 Lord Forsyth of Drumlean: I am not sure that you actually answered my question. You talked about evaluation but my question was how, if you have an emphasis on evaluation, you prevent donors from focusing on those projects that are easy to evaluate.

Professor Robert Picciotto: I should have answered the question more directly. Basically, evaluation has all the instruments to evaluate complex interventions. The problem arises when a particular method is reified as a gold standard. Currently experimental methods are widely viewed as highly relevant because they succeeded in the medical field—and relied on randomised control trials. If this approach is viewed as a gold standard, there is indeed the risk that you highlight: that one will do only projects that can be evaluated in that particular way. However, there are a number of other ways of evaluating development interventions. They should be selected and adapted case-by-case, since there is a wide range of tools available. That is what makes the job exciting and interesting. Reifying a particular method runs the risk you have pointed to. Today, unfortunately, there is a group of "randomistas" who promote randomisation as the only way to do evaluation. Paradoxically, that method does not strive for accountability. While it addresses the question of whether the system works, it does not ask why it works, who is making it work and so forth. That being said, there are cases where randomised control tests can be helpful, but one has to take account of how expensive and skill-intensive they are and the limitations of their use. When they can be used they should be used, but one should be aware of their limitations.

Q414 Lord Lawson of Blaby: I am conscious that time is pressing, so I will begin with an observation rather than a question. I was very pleased to hear the Governor stress the importance of reducing aid dependency over time. Aid dependency is a real danger. One of the things that we shall need to look at as a Committee is how fast a reduction in aid dependency can be implemented and over what period of time. That is of the first importance.

May I ask a question that is related more to your close neighbour, Kenya, with which you have a very close historical connection? I remember, as no doubt you can, when Kenya, Uganda and Tanganyika were administered by the British as a single entity. We have had some powerful written evidence—I do not know whether it is on our website yet, but it will be—from Sir Edward Clay, who served as the senior British diplomat in Kenya from 2001 to 2005, about the appalling corruption in Kenya, the connection between aid and corruption and the fact that, on his evidence, DfID was complicit in this. I am not suggesting for a moment that Tanzania is like Kenya in this regard, but is it a struggle to prevent this problem of corruption? How do you do it? Why is it so appallingly bad in your neighbour, Kenya?

Professor Benno Ndulu: I ask if I may be allowed not to comment on my neighbour—I cannot choose my neighbour—and instead speak to the issue indirectly. Corruption is a big problem. There is no doubt that it is a source of leakage. It also distorts incentives when the delivery of essential services depends on it. There is grand corruption and petty corruption. Petty corruption, unfortunately, has always been taken, as its name suggests, as unimportant. However, that is not true when you get feedback from the public. To a large extent, what you see on the street is a sharp response to that form of corruption. When people have to pay to get the services that they deserve, that is when the common man comes into contact with this. When you look at what we call internal corruption surveys, they rank those institutions that deliver services much higher than larger concerns. Unfortunately, when it comes to interaction with international aid givers, it is more the grand corruption that has been the issue. There is an issue of how to ensure that attention is given to both forms of corruption, partly because instability can be caused by ignoring petty corruption.

How did we stop it? To a large extent, the first measure was to remove or reduce opportunities for bargaining for services. When we removed foreign exchange controls and import controls, most corruption in the central bank disappeared as well. The forms of corruption that are more complicated now have to do partly with capacity, particularly when managing big projects where weaknesses in negotiations have tended to be a source of this. Unfortunately, the parties involved sometimes are multinational (go across borders) and it gets very complicated. One area where serious efforts have to be made now is capacity and the ability to draft appropriate contracts and to have transparent oversight over contracting. Most of the other forms of corruption, with the introduction of market systems and the simple removal of bureaucratic processes from the distribution of resources, have tended to disappears. This would be the number one area that I would provide for, along with access to resources like land.

I think that this is a winnable battle, not a hopeless one, but there is work to do. I know for sure that in my own Government there is a strong commitment to get corruption down and to implement those measures over time, which are important.

Q415 Lord Lawson of Blaby: Thank you very much for what you have said. May I pursue it a little further? Professor Picciotto told us how the model of development had changed from government control of the economy to a market system. Do either of you see a danger in Government-to-Government aid promoting strong Government, in a sense, which is inimical to the change—you need a Government, obviously—or can adversely alter the balance between the Government and the market economy and can stimulate corruption, if you do have a corrupt Government, as is certainly the case in Kenya, which the Governor was saying is such a problem?

Professor Robert Picciotto: Building the capacity of the state has proven to be very important, precisely to create the market institutions, the rule of law and the protection of property rights on which the private sector depends. Of course, having direct contact through open trade, foreign direct investments and connections between the civil society of the north and civil society in developing countries all contribute to the pluralism on which equitable and sustainable development depends. I agree with you that aid should be viewed as a connection between countries that involves not simply aid agencies but the peoples in those countries. It is also very helpful to bring into the picture the diasporas living in this country and other western economies. Going beyond aid is as important as Government-to-Government aid, although I would also say that in fragile states it is the weakness of the state that has created problems, not the strength of the state. In sum, one has to observe a balancing act in designing an aid programme.

Q416 Lord Lawson of Blaby: I have one last question to the Governor. President Nyerere, who was the longest-serving President of your country, was notably hostile to overseas aid. Do you think he had a point?

Professor Benno Ndulu: He was quite dear to aid and he got a lot of support, certainly from Scandinavian countries and others. What he was particularly strong about—I am using "strong" advisedly—was conditionality. His biggest fight was with the IMF, not with aid generally. That is my reading of that.

The Chairman: We are going to the last subject now.

Q417 Baroness Kingsmill: I wonder if I could ask a couple of questions around the issue of fragile states, in particular whether development aid and development agencies have a role to play in conflict prevention and post-conflict reconstruction. I understand you have done a fair amount of work in this area, Professor Picciotto, and I would be quite interested to hear your views about these two very important areas.

Professor Robert Picciotto: We have a lot of evidence from policy research on how to make development conflict-sensitive. Unfortunately, many of these lessons are not being applied in the development business. Take, for example, the Ivory Coast, which was viewed as a star performer. Look what happened there: a civil war! I am not saying that the main reason was aid insensitivity to conflict, but that was certainly part of the problem.

Aid should address the horizontal inequalities directly. To ignore regional disparities, particularly if they are along ethnic lines, is playing with fire. Investing equitably on a regional basis and being sensitive to the ethnic mix is an important aspect of conflict prevention.

The other aspect that one has to focus on is the youth bulge. Youth unemployment has been a source of conflict. We have seen this most recently in the Middle East with very high unemployment among young males. One part of the Millennium Development Goals that has not been emphasised enough is providing aid for programmes that create youth employment.

The management of natural resources, particularly lootable resources, also needs attention. You have only to look at the DRC as an example. The question of how to manage natural resources is very important, and aid can help to improve that management.

Finally, there is a question of conflict spillovers. Most of the civil wars that we see in developing countries cannot be contained within borders. A regional approach is therefore important. Regional co-operation programmes can also help. In West Africa, ECOWAS is playing a leading role in promoting that kind of co-operative interaction among West African countries. Post-conflict work should also be conflict-sensitive, because half the peace agreements collapse within 10 years. The way in which one does post-conflict reconstruction also has to be conflict-sensitive. Very often, the international system reacts to a conflict in a sequential manner and development comes too late. The cycle starts with elections, and humanitarian help and only then does one move on to development. This is very disruptive, because if you are demobilising combatants and they have no way of making a living other than violence and development has not yet been triggered, conflict may recur. Security sector reform and demobilisation, disarmament and reintegration programmes are highly dependent on a vigorous revival of the economy.

I am afraid that the international financial institutions have not been very conflict-sensitive in many countries and have not adapted their conditionality to situations in post-conflict eras. This said, the World Bank recently adjusted its strategies in post-conflict areas, and the most recent *World Development Report*, an excellent document, shows that the development community has learnt a great deal about how to handle fragile states and minimise conflicts. Implementing the lessons that are included in the *World Development Report* that the World Bank has produced would make a big difference.

Q418 Baroness Kingsmill: That can lead to tensions, perhaps, from the point of view of donor countries, between the Foreign Office, the Ministry of Defence and DfID equivalents. How do you see that playing out and resolving?

Professor Robert Picciotto: I fully agree that one needs a whole-Government approach here, not only within individual countries but across them. It is very important to have a single authority in a post-conflict situation. The United Nations usually provides that kind of leadership, but it needs to be strengthened on the development side. We need a whole-Government approach because diplomacy, defence and development should be together. This country has made significant progress along these lines. The challenge now is to get the whole development community and the humanitarian community to work closer together. That job still lies ahead of us.

The Chairman: Thank you both very much indeed for being with us. It has been a most helpful session and we are most grateful to you.

Nigeria High Commission—Written evidence

Introduction

1. The Select Committee of the House of Lords has called for evidence as part of its enquiry on the economic impact and effectiveness of aid. This brief has been prepared by the Nigeria High Commission in response to this call.

2. Nigeria is a country of over 150 million. Its economy is largely dependent on oil and gas, which accounts for 95% of Government revenue and 20% of the country's Gross Domestic Product (GDP). However, agriculture remains the mainstay of the economy. Nigeria's economy is the largest in West Africa, accounting for over 60% of the region's GDP. Per capita income is about $1500, thus raising issues of equity in income distribution and poverty levels.

3. In relative terms, Nigeria is not a major aid recipient country. Official Development Assistance (ODA) accounts for just 3% of the financial resources of the Federal Government of Nigeria or about 1. % of the country's GDP in 2007. Less than 1% of Nigeria's annual budget is dependent of foreign aid and not in the form of direct budget support. Among the EU member states, the UK has the largest development assistance programme in Nigeria.

4. Donor support is provided through direct project intervention and execution of projects in various parts of the country in partnership with Ministries, Departments and Agencies, State and Local Governments. Whereas the sum of 100 million Euros was set aside for Nigeria in 2008, only 59.3 million Euros was actually disbursed on various programmes and projects such as water supply and sanitation, institutional reforms, support for law enforcement agencies such as the EFFC, electoral reforms, the national census, immunisation programmes, etc.

5. EU aid disbursement process is slow and cumbersome, the funds are spread rather too thin on small projects across the country with the result that the overall impact on the people is limited. It has little or no effect on poverty reduction which is the primary aim of the various agreements that have regulated relations between the UK and Nigeria. Indeed, the World Bank rated the operational effectiveness of Nigeria's development cooperation strategy at "C", on a scale of A – E, A being the highest score while "E" is the lowest.

6. Despite its development challenges and domestic priorities, Nigeria is itself a donor country. Nigeria's aid is disbursed through various bilateral and multilateral programmes targeted at less-endowed Developing countries in Africa, the Caribbean and Oceania. The Technical Aid Corps Scheme (TAC) is a prime example in this regard.

7. QUESTION AND ANSWER SECTION

1. How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, what has been the impact of British ODA? How robust are results from studies in this area?

The impact of ODA on economic growth of Nigeria is not significant given the relatively small quantum of aid that the country receives as a percentage of its overall budget. For aid to make significant impact of economic growth, it must aim at employment generation and capacity building so as to assist in creating wealth. UK development programme in Nigeria covers a variety of areas including good governance, democracy, capacity building and institutional support, health, water and sanitation services.

Britain has committed itself to doubling of its development assistance to Nigeria in the spheres of technical cooperation, grants to non-governmental, not-for-profit organisations. British aid is particularly visible in the areas of education, health services and access to potable water and sanitation.

2. How does economic growth in countries which experience large surges in ODA compare to similar countries which do not?

This question cannot be answered very easily as it calls for a comparative study of available data. The Committee can get a better insight into the issue by comparing data that will become available from the evidence to be given by other stake-holders.

3. What lessons, if any, can be learnt from the experience of former aid-receiving countries that have graduated from reliance on ODA?

This subject is not applicable to Nigeria. As stated above, Nigeria is not aid-dependent, not because Nigeria is self-sufficient but because of its huge resource endowments and population.

4. What factors determine the effectiveness of ODA in recipient countries? Are they dependent on the scale and form of aid flows? How is aid effectiveness monitored?

The effectiveness of aid is determined by several factors, including the following:

a. absorptive capacity in terms of the institutional mechanism to utilise aid effectively and efficiently;
b. transparency and accountability in aid disbursement;
c. Involvement and ownership of recipient countries in the planning and execution of aid programmes.
d. Coordination of aid programmes by various donor agencies;
e. Needs assessment to determine priorities which must be set by the recipient countries in close collaboration with the donors.
f. Effective monitoring of programme and project execution.
g. Reduction in the quantum of tied aid so as not to overload the cost of aid delivery.

5. Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA? What has been the British government's experience?

Conditional aid is often viewed as an assault on the sovereignty of recipient countries. Among other things, conditional aid tends to restrict the flexibility of recipient countries in determining their national priorities.

6. How should ODA be allocated? How far do (and should) the Millennium Development Goals (MDGs) shape aid allocation?

ODA should be allocated on the basis of priorities mutually agreed between recipient and donor countries. MDGs should continue to serve as a useful guide in this regard. However, emphasis should be placed on areas in which the positive impact of aid can be felt the most.

7. How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached, would it lead to more official development aid than developing countries could efficiently absorb?

The UN target of 0.7% should continue to serve as the ultimate aim. It is an ideal to which all donor countries should aspire to meet, if their commitment to MDGs is to produce the desired effect. If the target was reached, it would certainly lead to more aid flows. But for the increased flows to be effective, they should be disbursed on the basis of the needs, absorptive capacities and the other factors identified above as necessary prerequisites for the effectiveness of aid.

8. Does ODA complement or inhibit private investment in developing countries?

Aid should complement rather than inhibit private investments in developing countries particularly if it assists in wealth creation and income generation. A healthy, educated and skilled populace, which could be a positive outcome of effective aid, contributes to the creation of conducive conditions for private investment to thrive. It could also increase the disposable income of the citizenry, thus creating market opportunities for manufactured goods and services.

9. How does ODA and British aid in particular, interact with financial flows from other sources including new donors such as China, India and Brazil, private capital flows and philanthropic sources?

Ideally, the flow of aid from diverse sources should complement each other, but there is the need for harmonisation and closer collaboration in aid delivery. Multiplicity of donor agencies and priorities can be counter-productive. This is why recipient countries must be involved in aid coordination and in setting national priorities, to obviate duplication of efforts. In this regard, an effective international mechanism needs to be found to ensure better coordination and harmonisation of aid between the OECD-DAC and other donors such as Japan, Brazil and India.

10. How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

At the global level, better harmonisation and coordination is required, to address some of the root causes of conflict and the international efforts at resolving them. Development assistance should aim at capacity building in fragile states, to enhance the capacity of the State to deliver on social and economic outcomes.

11. What are the prospects for using aid to support market-based initiatives, for example in providing insurances against earthquakes damage?

Not applicable to Nigeria, but the response provided to Question 8 above is pertinent.

12. In what ways, if any, can the British government improve the effectiveness of its development aid?

By addressing the factors identified in the response to Question 4 above and by using local capacities and content in Nigeria for the delivery of development aid.

30 June 2011

ONE—Written evidence

ONE is a grassroots advocacy and campaigning organisation dedicated to the fight against extreme poverty and preventable disease, particularly in Africa. We have more than 2.5 million members worldwide and work in close partnership with African leaders, entrepreneurs and activists to support sustainable development and economic growth by Africans, for Africans.

To learn more about ONE, please visit www.one.org

The inquiry questions we seek to address are in brackets after each sub-title.

ONE also endorses the UK Aid Network submission.

Overseas Development Assistance and Growth (Question 1 and 8)

1. Well spent ODA plays a highly important role in catalysing economic growth and in ensuring that growth benefits the poorest people. In the last decade 46 million more children are in school and since 1990 the number of child deaths annually has declined from 12.5 million to 8.1 million despite an increasing number of children being born. SMART aid – that which is Sufficient, Measurable, Accountable, Responsive and Transparent – invested in health, education, agriculture, climate change adaptation and infrastructure provision is helping to save lives whilst also establishing the conditions needed for successful economic growth.

2. ODA spent on childhood vaccines reduces illness and deaths from preventable diseases such as measles and pneumonia. The UK commitment to the Global Alliance for Vaccines and Immunisation of £814 million up to 2015 will vaccinate 80 million children and avert an estimated 1.4 million child deaths. In doing so stress on health systems will be alleviated and children will stand a better chance of living a healthy adult life. This allows people to make a fuller contribution to the economy without placing a preventable burden on local health systems.

3. Investments in small holder agriculture helps farmers grow enough crops to feed their families and sell surpluses. This means their children eat well, develop properly, go to schools with the energy to pay attention and learn essential skills for jobs. It also reduces the amount of money the family has to spend on providing for their basic food needs. This means families can invest this income in supporting the local economy and small businesses.

4. Investments in health and agriculture not only improve lives but benefit the economy in the long run. Investments in education are similarly rewarding. Recent studies have found that improving education could increase long-run economic growth by 2%[319]. ONE's Living Proof campaign provides a number of examples of how SMART aid investments are changing lives for the better and can be found online: http://one.org/livingproof/en/

[319] Education for all: beating poverty, unlocking prosperity - http://www.campaignforeducation.org/docs/reports/brown/EFA%20Report_Low%20Res%20v2.pdf

5. ODA also improve lives indirectly by creating the conditions necessary for economic growth. ODA helps overcome capital constraints and/or helps to mitigate risk that otherwise prevents investments in infrastructure. For example access to electricity is now widely recognised as essential to achieving the MDGs as well as for business and economic growth. Currently it is not economically viable for private companies to supply electricity to many rural regions in Africa due to the high capital investment cost and slow payback time. This major bottleneck to development needs to be addressed. ODA should be used to leverage equity, or partly pay for such electricity projects. When using ODA to leverage private finance it is important that ODA is only used to fund projects that otherwise would not have gone ahead.

6. The role of ODA should also be to ensure in poor countries where economic growth is occurring there is comparable poverty reduction. The Washington Consensus that economic growth 'trickles down' to the poorest is increasingly contested[320]. Since the second half of the 1990s, a period of relatively high growth has helped reduce poverty in many African countries. However, in several countries, owing to the persisting unemployment and highly unequal income distribution, the poor did not benefit from GDP growth[321]. This is the complex relationship between economic growth and poverty, because while growth does affect poverty, there are many other confounding factors at play. Poverty is both much higher and less elastic to growth in SSA than anywhere else[3].

7. Therefore, ODA is not only morally rightly in saving lives and raising people's standard of living, but it can also help ensure the poorest benefit from economic growth, create jobs for the poorest, increase stability and generate an environment for further economic growth and development.

Transparency, Accountability and Results – through the lens of country ownership (Question 4 and 12)

8. The Fourth High Level Forum on aid effectiveness, to be held in Busan, South Korea, in November/December this year, presents an opportunity to revitalise the aid effectiveness agenda by putting transparency, accountability and results centre-stage. Working alongside like-minded donors and listening carefully to the views of African governments and civil society, the British Government must do what it can not only to put the focus on transparency, accountability and results, but also to ensure that they are seen through the lens of country ownership – the key to sustainable, people-centred, development.

9. Transparency and accountability of resources and results are essential elements in the fight against poverty. Taken together, these priorities help to build a virtuous circle of increasingly effective aid. Transparency of policies, spending and results enables citizens to hold their governments to account, driving faster progress on poverty reduction. Monitoring and reporting on results then provides a basis for feedback, learning and another round of progress. In the absence of transparent and accountable governance, health, education, and other services will not be delivered efficiently, civil society will not flourish, conflict-affected countries will remain trapped in repeated cycles of violence and

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320 Rodrik, D. (2006). 'Goodbye Washington consensus, hello Washington Confusion?', *Journal of Economic Literature,* vol. 44, (December), pp. 969-983.

321 The G20 and African Development - http://www.odi.org.uk/resources/download/5707.pdf

instability, and resources for development—aid, as well as domestically generated resources from tax or natural resource rents—will not be used effectively.

10. In the vanguard of this agenda, the British Government has a responsibility to ensure that a focus on transparency, accountability and results supports rather than undermines progress towards enhanced domestic accountability in developing countries. This is the key for long-term development that – rather than imposing inappropriate blueprints of development (what the Harvard academic Matt Andrews refers to as "hippos in the Sahara" - animals that may look impressive but eat up resources and are inappropriate for a context where camels would be better) – responds to the challenges faced by particular countries. Aid needs to be provided in ways that open up space for domestic actors such as parliaments, audit institutions, civil society organisations, and the private sector in developing countries to hold their governments to account.

11. In all areas, the agreements reached at Busan need to be mutual – with both developing and developed countries making commitments. On transparency, developed countries must be transparent about the aid that they provide, with adherence to the International Aid Transparency Initiative the goal, while developing countries should be committed to providing more information to their citizens on domestic budgets. Transparency is also an integral part of mutual accountability to developing country beneficiaries. Donors and partners must also commit to providing greater information, voice, and participation to civil society in developing countries to ensure true country ownership and buy-in for sustainable development. And when managing for results, donors need to balance their concerns regarding 'value for money', with true accountability to citizens in developing countries who will be the ultimate beneficiaries of development projects. Monitoring and evaluation will thus be a shared responsibility, with donors supporting capacity for developing countries to better monitor aid programs and hold governments to account for shared goals.

The TRACK principles (Question 4 and 5)

12. To have maximum impact ODA needs to conform to the TRACK set of principles for monitoring aid commitments. In other words is the promise **T**ransparent, **R**esults-oriented, **A**dditional, are any **C**onditionalities clear, and how will we know whether it is being **K**ept? For more information on the TRACK principles please visit: http://www.one.org/c/international/policybrief/3298/

13. **Is it transparent?** Every numerical commitment should come with – or be swiftly followed by - a clear presentation which shows: over how many years the commitment is for; a clear deadline; which budget line item the commitment is coming from; what the initial baseline is; and how the budget line item will change in future years. Often official commitments are multiannual, and one lump sum is announced when in fact it is the sum of many individual separate annual contributions. Therefore every ODA commitment should have all the key information disclosed by each donor separately about that promise. This information needs to be comprehensive, comparable and timely, and be available and accessible to the citizens of both recipient and donor countries. All this information should be available and accessible, ideally in machine readable formats, on websites and in line with the International Aid Transparency Initiative format standards.

14. **Is it results-orientated?** Financial promises should link expenditure to real-world outcomes. A clear presentation of desired results will help the citizens of developing countries hold their government accountable for delivery of these results.

15. **Is it additional?** Perhaps the most difficult aspect of promise making, and one which makes it vulnerable to abuse, is judging whether or not any of the money promised is new and additional – something which is often demanded by activists and claimed by promise-makers. However, claims of additionality are quite slippery. If implemented adequately the first principle of transparency should take care of many of the concerns about additionality. But because of confusion about the term it is proposed that it be its own special principle. The scope for confusion can be readily seen. For example, spending may be 'additional to previous levels', 'additional to promised increases above current levels that were already previously planned', or 'additional for the issue in question but at the expense of other objectives within the overall budget'. New additional money for any given initiative could come either from efficiency savings, or from a reallocation from other budgets, or from an entirely new allocation into the budget as a whole – all this information should be readily accessible or a judgement about additionality will be hard to make. Overall, every promise that claims to be 'additional' must answer the question 'additional to what?'

16. **Is it conditional?** Often increases in resources are conditional upon changes in policy, both from the government and other agencies who are programming the resources, and above all from the recipient developing country implementing partner. Some conditionalities are onerous and much research has shown that conditions that impose policy choices on the recipient tend to be counterproductive. Others are important and necessary (i.e. the need for fiscal transparency and good audits and monitoring of projects). In either case, however, it is important for the conditionalities to be clear and openly presented.

17. **How will we know when it's been kept?** As part of any major promise a mechanism should be identified, preferably an independent mechanism, to measure and monitor progress through the lifecycle of the promise to help ensure the promise is kept and performance along the way is publicised to citizens and the media. Key moments should be identified, such as G8 summits, where public interim progress reports can be delivered. This mechanism should build on and support domestic accountability systems in the recipient countries.

UK legislation to lock in spending 0.7% GNI on ODA (Question 7)

18. ONE supports the commitment in all three major political parties' manifestos to pass legislation to spend 0.7% of UK GNI on ODA. Combined with the focus on results, transparency and accountability, this commitment will improve the effectiveness of UK aid on the ground by allowing effective programmes to be scaled up. It will also strengthen UK leadership internationally, providing conclusive proof that the UK keeps its promises whilst putting pressure on other donors to deliver theirs. In addition there are two key ways in which legislation will make a difference to effectiveness.

19. Legislating 0.7 will give predictability to recipients and programmers over a longer time frame, allowing more efficient planning and a focus on results over the long-term as well as the short.

20. In the future such legislation will take the political focus away from volumes of ODA and allows practioners and campaigners to focus on the key issues of aid impact, and improving transparency and accountability.

July 2011

Stephen Booth, Research Director, on behalf of Open Europe—Written evidence

1. The UK spent £7,767m on external aid in 2009/10, £1,424m of which via the European Union. The EU is by far the biggest recipient of UK multilateral aid spending, receiving over half of the UK's multilateral aid budget in 2009/10 and 18% of the UK's total aid spending.[322] The Government has taken steps to achieve greater value for money from its aid and has stated that its "plans to redraw the aid map will concentrate efforts on countries where UK aid will, pound for pound, achieve the best results in fighting poverty and building a safer world, and where Britain is in the best position to deliver results".[323] Part of this "redrawing of the map" should include an evaluation of UK aid that is spent via the EU.

2. In 2010, the EU institutions disbursed €9.7bn in Official Development Assistance (ODA) on behalf of member state governments.[324] The question is whether it makes sense for member states to provide so much of their aid via the EU institutions and whether it is spent effectively?

3. Since 2000, in response to criticism about the effectiveness of EU aid, the European Commission has embarked on a series of reforms.[325] However, despite these reforms it remains unclear whether the Commission's role is to act as an all-encompassing aid donor or as a niche player complementary to the member states' existing aid programmes. While the EU could fulfil a valuable coordinating role, it makes no sense for the EU to be a '28th donor' with a large bureaucracy in parallel with the member states.

4. Despite the Lisbon Treaty stating that the EU's development policy "shall have as its primary objective the reduction and, in the long term, the eradication of poverty," not enough EU aid reaches the world's poorest countries. Geopolitical considerations (immigration from and political stability in neighbouring countries) and old colonial ties still dictate where much of the EU's money is spent. In 2009, the latest figures available,[326] only 46% of EU aid reached low income countries, compared with 74% of UK aid, 58% of EU member state governments' aid and 56% of United States aid.

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322 *DFID*, 'Statistics on international development 2005/6 – 2009/10', 2010, p19; http://www.dfid.gov.uk/Documents/publications1/sid2010/SID-2010.pdf; This is the UK's Gross Public Expenditure on aid, which includes DFID's aid budget and all other sources of UK aid.

323 *DFID* press release, "Mitchell redraws aid map to transform lives of millions", 1 Mar 2011 http://www.dfid.gov.uk/Media-Room/Press-releases/2011/Mitchell-redraws-aid-map-to-transform-lives-of-millions/

324 OECD figures show that the EU institutions disbursed $13.5bn in ODA in 2010 (2009 prices and exchange rate); http://www.oecd.org/dataoecd/54/41/47515917.pdf. Using the ECB's 2009 $-€ exchange rate of 0.716949 this gives EU institutions a figure of €9.7bn disbursed ODA. Disbursements are less than commitments, which in 2009 totalled €12.3bn.

325 See *Open Europe*, 'EU aid: is it effective', 2007 for a more in depth discussion about the history of EU aid; http://www.openeurope.org.uk/research/euaid.doc

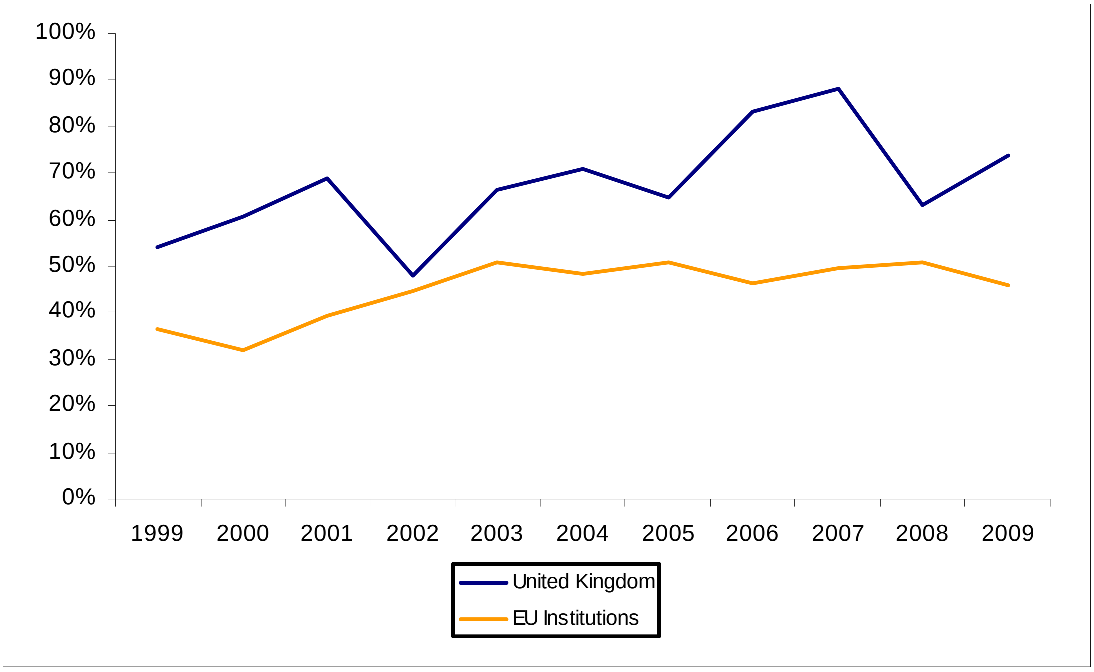
326 At the time of publication the OECD had released its figures for overall aid spending for 2010 but not a breakdown of where funds had been spent so we have used the 2009 figures.

% of aid to low income countries

Year	UK	EU member states (DAC members[327])	EU institutions
2009	74%	58%	46%

OECD DAC database, % of allocable net ODA disbursement to least developed and low income countries; http://stats.oecd.org/index.aspx

% of aid to low income countries



OECD DAC database, % of allocable net ODA disbursement to least developed and low income countries; http://stats.oecd.org/index.aspx

5. In 2009, the entire EU external aid budget was €12,298m, €11,764m of which was counted as ODA.[328] Under the broad definition of ODA, aid to Turkey, for example, through the EU's pre-accession funds is counted in the same way as EU development spending in sub-Saharan Africa.[329] Turkey, which is an upper middle income country, tops the list of recipients of EU aid, receiving €571m in 2009.

6. There is a legitimate discussion to be had about whether the Commission is simply funding countries that the member states would be helping anyway – what officials describe as the 'division of labour'. But the UK's Development Minister Andrew Mitchell has called on the EU's aid to be far more "targeted at the poorest people"[330], while the Netherlands' Europe Minister Ben Knapen has suggested, "We need to help our

327 Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the UK are members of the OECD's Development Assistance Committee.
328 Figures differ to those above because of distinction between "commitments" and "payments"
329 *European Commission*, 'Annual report 2010 on the European Union's development and external assistance policies and their implementation in 2009', 2010, Tables 6.3, 6.4 and 6.5, p170-1; http://ec.europa.eu/europeaid/multimedia/publications/documents/annual-reports/europeaid_annual_report_2010_en.pdf;
330 *Telegraph*, 'EU 'wastes billions in aid", 18 April 2011; http://www.telegraph.co.uk/news/worldnews/europe/eu/8457729/EU-wastes-billions-in-aid.html

neighbours, that is in our interest. But such assistance must be reconsidered, especially when it comes to the significant assistance to candidate countries such as Turkey."[331]

7. The majority of EU development aid is spent as a portion of the EU's central budget, to which all member states contribute. The rest is spent via the European Development Fund (EDF), to which member states contribute voluntarily.[332] This aid is managed by various departments within the European Commission, the EU's newly formed External Action Service and EU delegations in third countries.

8. In its 2011 multilateral aid review, DFID noted that, while the EDF (€3.6bn a year) has a strong poverty focus (85% of funds are spent in low income countries), more than 85% of the EU's other development aid programmes' budget (€7bn a year) is spent in middle income countries. The EDF is rated "strong" on both its contribution to the "UK's development objectives" and on its "organisational strengths" but the rest of the Commission's aid budget is rated "weak" and "satisfactory" on the same respective measures.[333] Despite this varying performance, in 2009/10, the UK contributed £397m to the better performing EDF but a much higher £789m to the poorly targeted and less effective central Commission budget.[334]

9. DFID officials have suggested that the UK had been able to "drive much better performance with the EDF" rather than other EU aid because the latter was an "assessed contribution over which we have very little choice over the amount."[335] This illustrates the need for accountability: a clear link between aid priorities and UK contributions.

10. Under the terms of the UK's Comprehensive Spending Review, DFID, which manages around 86% of the UK's development aid, is committed to reducing its running costs, which include administration and frontline staff, from 4% to 2% of the total budget by 2014-15.[336] In contrast, the EU's administration costs, as a percentage of ODA disbursed, currently stand at around 5.4%.[337]

11. In addition to this internal bureaucracy, the EU channels a huge amount of money through other international multilateral organisations. In 2009, agreements for a total of €935 million and €469 million were signed with the UN and the World Bank Group,

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331 *Foreign Ministry of the Netherlands*, 'Nederland wil opheldering over foute EU hulpprojecten', 19 April 2011; http://www.rijksoverheid.nl/ministeries/bz/nieuws/2011/04/19/nederland-wil-opheldering-over-foute-eu-hulpprojecten.html

332 *DFID*, 'Multilateral aid review: assessment of European Commission budget', 2011; http://www.dfid.gov.uk/Documents/publications1/mar/ecbudg.pdf; and *DfID*, 'Multilateral aid review: assessment of the European Development Fund', 2011; http://www.dfid.gov.uk/Documents/publications1/mar/edf.pdf

333 *DFID*, 'Multilateral Aid Review: Ensuring maximum value for money for UK aid through multilateral organisations', March 2011, p170-171; http://www.dfid.gov.uk/Documents/publications1/mar/multilateral_aid_review.pdf; DFID also rates the European Commission's €800m humanitarian aid office, the ECHO, giving it scores of "strong" for meeting the UK's development objectives and "satisfactory" for organisational strengths.

334 *DFID*, 'Multilateral Aid Review: Ensuring maximum value for money for UK aid through multilateral organisations', March 2011, p170-171; http://www.dfid.gov.uk/Documents/publications1/mar/multilateral_aid_review.pdf

335 *HoC International Development Committee*, 'DFID's Performance in 2008–09 and the 2009 White Paper', 2010, p39-40; http://www.publications.parliament.uk/pa/cm200910/cmselect/cmintdev/48/48i.pdf

336 *HoC International Development Committee*, 'Department for International Development Annual Report & Resource Accounts 2009–10', 2011, p5; http://www.publications.parliament.uk/pa/cm201011/cmselect/cmintdev/605/605.pdf

337 *European Commission*, 'Annual report 2010 on the European Union's development and external assistance policies and their implementation in 2009', 2010, p186, Table 6.14 shows total ODA at €9,799.7m and administration costs of €524.48m.

representing around 10% of total EU aid commitments.[338] This means a wasteful chain of transfers: national agencies administering a transfer to the EU, which then administers a transfer to either the UN or World Bank, which then administer the final transfer of aid to the recipient country – with administrative costs and delay at each stage. The result is that less aid reaches the people that need it. The UK is surely capable of transferring money directly to these institutions rather than via the EU.

12. Since the EU's 2005 'Consensus on Development', the Commission has placed more focus on co-ordinating the division of labour between itself and member states and among member states. However, the logic underpinning the EU's coordinating role is still centralisation and, in particular, the centralisation of financing. Under so-called "Delegation agreements", national governments' contributions to the EU aid budget are now, in some cases, being sent back to member states because they, rather than the Commission, are judged to be the best conduit to deliver aid to a given country.

13. However, what in theory is a good idea (simplifying the number of donors and prioritising the most effective donors operating in recipient countries), under the current system in practice, simply generates greater bureaucracy and cost at the EU level. It makes no sense for member states to hand over money to the Commission only to get it back again before delivering it to recipient countries. In 2009, there were 48 Delegation agreements (from the Commission to a member state) under preparation or signed for a total of €242.7 million.[339] The system does also work the other way, with member states delegating additional amounts of their bilateral aid to the Commission.

14. Delegating aid to the EU in such a way involves one less transaction and is potentially a good model for providing aid voluntarily through the EU. However, in contrast to the 47 agreements worth €242.7m to delegate aid *back to the member states*, there were only 17 agreements worth €123.3m where member states have decided to hand extra aid *to the Commission*. This begs the question of why the net difference (€119.4m) was ever handed over to the EU in the first place.

15. The EU has placed an increasing emphasis on delivering its aid as 'budget support'. According to its own figures, the Commission has committed over €13bn in budget support between 2003 and 2009 (about 25% of all commitments in this period). About 56% of commitments were made in Africa, Caribbean and Pacific (ACP) countries, 24% in neighbourhood countries (Eastern Europe and the Mediterranean), 8% in Asia, 6% in Latin America and 5% in South Africa.[340] In 2008, then European Development Commissioner Louis Michel argued, "Budget support and more of it is the only answer", and committed to increasing budget support up to 50% of the EU's total aid.[341]

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338 *European Commission*, 'Annual report 2010 on the European Union's development and external assistance policies and their implementation in 2009', 2010, p12 and 162; http://ec.europa.eu/europeaid/multimedia/publications/documents/annual-reports/europeaid_annual_report_2010_en.pdf
339 *European Commission*, 'Annual report 2010 on the European Union's development and external assistance policies and their implementation in 2009', 2010, p25; http://ec.europa.eu/europeaid/multimedia/publications/documents/annual-reports/europeaid_annual_report_2010_en.pdf
340 *European Commission*, 'Green Paper on the Future of EU Budget Support to third countries', 19 October 2010; http://ec.europa.eu/development/icenter/repository/green_paper_budget_support_third_countries_en.pdf
341 *European Commission*, 'Budget support: a question of mutual trust', 2008, p4; http://ec.europa.eu/development/icenter/repository/LM_budget_support_en.pdf

16. The Commission argues that the use of budget support promotes "local ownership" and ensures "alignment of aid with national policy". It is argued that such support has "had a positive impact for instance on dialogue with partner countries, donor coordination, public financial management and policy reforms in the beneficiary countries," although it admits these findings "cannot be generalised."[342] By aiming to increase budget support to 50% there is clearly a risk of the Commission 'picking winners' when it comes to development policies.

17. The recent events in North Africa and the Middle East illustrate the dangers of directly supporting potentially illegitimate regimes rather than civil society groups. The EU had planned, for example, between 2011 and 2013 to grant 50% of its €149.76m a year funding to the now-discredited Egyptian government as budget support.[343] In a recent consultation on the Commission's use of budget support the Dutch government stated that, "the Commission sometimes underestimates the risks and sensitivities associated with this aid modality. As a result, the Commission may, in certain cases, provide budget support too readily." It stated that that due to the lack of regard to "good governance, human rights and fighting corruption" the Dutch government could not support the Commission's recent proposals to grant budget support in the DR Congo, Namibia, Armenia, Algeria and Nicaragua.[344]

18. The European Commission also rarely gets a good 'bang for its buck' in terms of influencing recipient governments' performance with its budget support. The European Court of Auditors (ECA) has noted that, "the Commission often does not play the role in dialogue that could be expected, given its significant financial contributions."[345] Meanwhile, the ECA also warns that the "rationale followed by the Commission in deciding on the amount of funds to be allocated to general budget support in each country is not clear", and calls for the Commission to "demonstrate that the amount allocated to individual programmes is appropriate in view of the objectives and the framework for dealing with risks and benefits".[346]

19. Questions should therefore be raised about how much influence the UK Government has over the use of budget support to deliver EU aid and the power it has to block its use in countries that do not satisfy good governance or human rights criteria or where taxpayers are not getting value for money.

20. In our view, the Government should consider the following approaches to reforming EU aid:

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342 *European Commission*, 'Annual report 2010 on the European Union's development and external assistance policies and their implementation in 2009', 2010, p12-13; http://ec.europa.eu/europeaid/multimedia/publications/documents/annual-reports/europeaid_annual_report_2010_en.pdf

343 *European Commission*, 'European Neighbourhood and Partnership Instrument Arab Republic of Egypt National Indicative Programme 2011-2013', p7 and p27; http://ec.europa.eu/world/enp/pdf/country/2011_enpi_nip_egypt_en.pdf

344 *Dutch Government*, 'The Dutch government's response to the European Commission's Green Paper *'The future of EU budget support to third countries'*, COM(2010)586, of 19 October 2010', p2; http://ec.europa.eu/development/icenter/files/green_paper_contributions_future_eu_budget/Public%20Authorities/gp_pa_NL_en.pdf

345 *European Court of Auditors*, 'The Commission's management of general budget support in ACP, Latin American and Asian countries', 2010, p39; http://eca.europa.eu/portal/pls/portal/docs/1/7036731.PDF

346 *European Court of Auditors*, "The effectiveness of the Commission's management of General Budget Support in ACP, Latin American and Asian Countries", p1, 2011, http://eca.europa.eu/portal/pls/portal/docs/1/7106723.PDF

- Contributions to the EU aid budget should be made entirely voluntary as the European Development Fund (EDF) element already is. The UK should spend its aid budget directly through DFID, which performs better as a donor than the Commission on most measures, especially regarding the targeting of poverty, unless there is a demonstrable EU 'value added' in which case it could opt into specific EU programmes, such as the EDF.

- It is widely acknowledged that greater co-ordination of member state development programmes is crucial to increase aid effectiveness. Currently, developing countries have to deal with 27 different EU donors, plus the Commission, each with their own policies. Therefore, to reduce the administrative burden on aid recipient governments, a strong case can be made for greater harmonisation of procedures.

  The role of the EU should be to provide a forum for coordination between donors, rather than acting as a 28th donor. This would allow it to provide a resource for small member states with limited diplomatic networks to coordinate their spending, and divide up responsibilities if they wish. It would mean large savings on administration costs.

- As budget support is less bureaucratic it is a way of getting money out of the door faster but, as the share of budget support increases, the risk is that speed is traded for effectiveness and accountability. Due to the inherent uncertainty and risks involved in providing budget support directly to recipient governments, the European Commission should consider setting a 25%-30% limit on the portion of budget support as a total of EU aid. Development funding is a complex exercise that entails risks of waste and inefficiency; therefore the Commission should avoid picking winners when it comes to particular aid policies.

- Aid works only when it is combined with good policies and institutions. A large share of the responsibility lies with developing country governments, but the policies used by donors also matter. In particular, the EU should open up to globalisation and embrace the inflow of goods, people and ideas from the developing world. A good first step would be the phasing out of the Common Agricultural Policy, and a commitment to an ambitious opening of trade with developing countries.

30 June 2011

For more information, please see the following Open Europe publications:

Open Europe, 'EU aid external aid: who is it for', 2011; http://www.openeurope.org.uk/research/euaid2011.pdf

Open Europe, 'The EU and the Mediterranean: good neighbours?', 2011; http://www.openeurope.org.uk/research/enp2011.pdf

Organisation for Economic Co-operation and Development—Written evidence

Jon Lomøy, Director, Development Co-operation Directorate, Organisation for Economic Co-operation and Development
Karen Jorgensen, Head of Review, Evaluation and Engagement Division, Development Co-operation Directorate, Organisation for Economic Co-operation and Development

Re: Call for Evidence: The Economic Impact and Effectiveness of Development Aid

As a submission to the above parliamentary enquiry, I am writing to draw your attention to a few select pieces of research, policy guidance and international good practice standards and agreements that I feel are relevant. While we have been looking into a variety of relevant areas in the OECD and in the Development Assistance Committee, there are three key issues to which I would like to draw your attention. These are:

1. Making how aid is provided more effective.
2. Providing support more effectively in fragile states and situations.
3. Increasing the effectiveness of how official development assistance is allocated.

1. Aid Effectiveness: making sure how we deliver aid supports development results

Background:

In the first few years of the 21st century there was a growing realisation amongst aid donor governments, partner governments and other stakeholders like civil society, that the way aid was being provided in many cases was actually diluting its effectiveness. Too many actors doing too many different, disconnected and often duplicative things was not producing a broad impact of either poverty reduction or economic growth. At the same time the transaction costs involved for partner governments, working with dozens of different partners each with different procedures to adhere to involved enormous transaction costs for those governments and took up valuable staff capacity and time.

Action:

It was the recognition that the way aid is delivered can have a negative impact on how effective it can be for achieving partner countries' development objectives (whether these objectives are poverty reduction, economic growth or both) that drove the agenda at the series of high level fora on aid effectiveness (Rome in 2003, Paris in 2005, Accra in 2008 and still to come Busan in 2011). [347]

At the second of these high level fora, held in Paris in 2005, a declaration was agreed which emphasised five principles which donors and partners should adhere to in order to improve how aid is used. The principles that the **Paris Declaration on Aid Effectiveness** highlights are:

[347] You can read more about the history of the high level fora at: http://www.oecd.org/document/63/0,3746,en_2649_3236398_46310975_1_1_1_1,00.html

1. Ownership: Developing countries set their own strategies for poverty reduction, improve their institutions and tackle corruption.

2. Alignment: Donor countries align behind these objectives and use local systems.
3. Harmonisation: Donor countries co-ordinate, simplify procedures and share information to avoid duplication.
4. Results: Developing countries and donors shift focus to development results and results get measured.
5. Mutual accountability: Donors and partners are accountable for development results

When the parties met again in 2008 in Accra, there was a push to make progress on delivering the changes to how aid is managed agreed three years earlier in Paris and also to bring partner countries more into the centre of the discussions. The **Accra Agenda for Action** was born. In it, adherents reaffirmed the objectives of the Paris Declaration while also deepening their emphasis on ownership, more inclusive aid partnerships (including civil society) and indeed on delivering results for development. It also highlighted that aid should play a role in supporting partner countries to develop their own capacity so that they become less and less reliant on external assistance. [348]

Progress:
We have been monitoring progress against the objectives of the Paris declaration through a series of monitoring surveys, evaluations and also a sector specific study.

Progress made by the countries adhering to the Declaration is assessed using 15 quantitative indicators and targets, complemented by qualitative evidence gathered in developing countries. The first two surveys measuring progress are already available (2006 and 2008) and findings of the third survey will be published later this year. [349] Preliminary estimates for progress at the global level, drawing on evidence submitted for the 2011 survey suggest that:

1. Significant progress has been made in some areas:
   - More partner countries have sound and better prioritised national development strategies in place
   - Higher quality results-oriented frameworks are in place in many developing countries, with evidence suggesting that relevant statistics are becoming increasingly available at the country level.
   - Donors now untie (i.e. de-linking aid from goods and services provided by the donor) a greater proportion of their aid to the poorest countries.

2. Progress has been moderate, or mixed, in others:
   - Evidence on the commitment to broaden ownership – including on the participation of non-state stakeholders in aid and development processes – is partial.
   - Efforts to improve support for capacity development have been mixed. While donors are co-ordinating their support better, much of it still remains supply driven.

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348 Both the Paris Declaration and the Accra Agenda for Action are available at http://www.oecd.org/dataoecd/30/63/43911948.pdf
349 The results of the two surveys and evaluations are available here: http://www.oecd.org/document/44/0,3746,en_2649_3236398_43385196_1_1_1_1,00.html The findings of the 2011 Survey on Monitoring the Paris Declaration will be published in a Report on Progress since Paris (working title) in September 2011.

- One third of the 80 or so participating partner countries showed an improvement in the quality of their public financial management systems. Other countries saw setbacks in the quality of their systems.
- Donors are using partner country systems more, and setting up additional parallel implementation units less, but not yet to the decreased extent aimed for.

3. On aggregate, little or no progress is likely to be observed in some areas:
   - Preliminary evidence suggests that little progress has been made towards targets on joint missions and analytic works designed to reduce the burden on partner countries of often fragmented donor processes.
   - Despite a few promising initiatives, efforts to reduce the fragmentation of aid have been limited.
   - Progress in improving the medium term predictability of aid at the country level appears to have been limited.

The final results of this third survey will be available in September.

As a complement to the monitoring surveys, an **independent evaluation of the Paris Declaration** – finalised in 2011 –considers the relevance, efficiency and impact of the Paris Declaration and efforts to implement it (included as Annex 1 to this submission[350]).

In addition, in order to track the wider impact of the changes to development co-operation, we have been looking more closely at the **health sector.** The health sector provides a prime example of an area where there were a plethora of different donor funded initiatives, organisations and activities, many of which were not co-ordinated with each other. As **Annex 2** to this submission[351], I would like to share with you the final report on looking at health as a tracer sector in monitoring aid effectiveness. This detailed report highlights that although the sector still remains a very complex one from a financing and aid management perspective, progress in applying the principles agreed in Paris in 2005 is evident. It also shows that progress in making aid more effective has created the conditions for progress towards the ultimate goal: better health outcomes. The report concludes that there is evidence that aid effectiveness improves sector planning, budgeting and governance capacities, strengthens national systems, and contributes to health results through more efficient and sustainable implementation of national health policies, plans and strategies.

2. Aid in fragile states and situations: complex and crucial

Background

The aid effectiveness principles are relevant to all development contexts, but in fragile and conflict affected states there are very specific challenges which can require a specific and particularly sensitive approach from donors. In many cases, these states face severe development and security challenges including chronic humanitarian crises, persistent social tensions, violence or the legacy of civil war, weak governance, limited administrative capacity, and limited credibility or legitimacy amongst the people. I would like to highlight two main practical implications of this complex reality, for making development co-operation in fragile states as effective as possible:

[350] Not published here.
[351] Not published here.

- Firstly, the top priority may not be economic growth as such, but laying the groundwork for it through stabilisation and peace building. To assess whether aid has been effective, it should be judged against intended objectives. In some cases, this may not have been economic growth per se.
- Secondly, experience shows that aid and the involvement of external actors, though intended to support peace and development, can play a more nuanced and in some cases negative role ("doing harm"). Aid can become part of the conflict dynamics. Therefore, how aid is targeted and managed is these situations can be acutely important.

Action

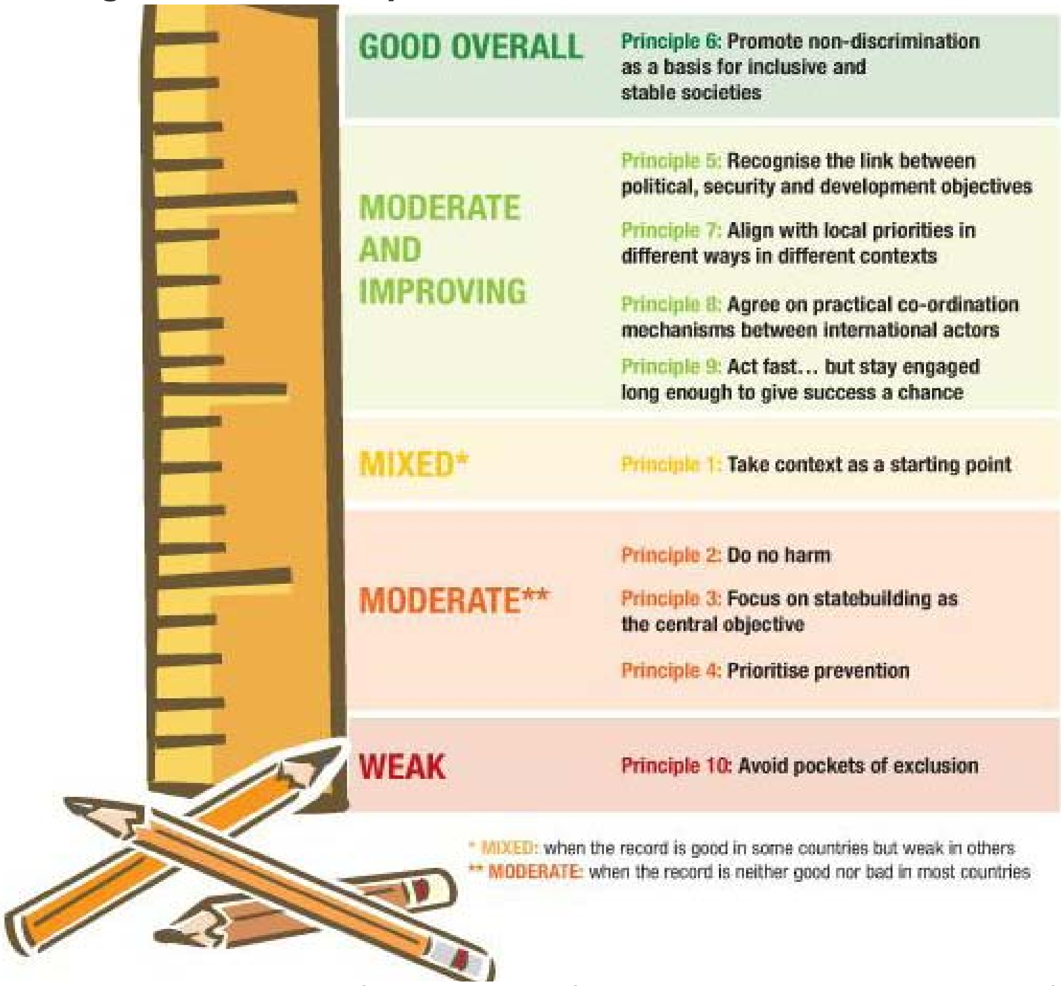
In 2007, OECD Ministers adopted the **Principles for Good International Engagement in Fragile States and Situations**. [352] These principles provide a set of guidelines for actors involved in development co-operation, peacebuilding, statebuilding and security in situations of conflict and fragility. The principles are now widely accepted as a point of reference. The principles were established to help guide donors to make their aid as effective as possible, and indeed to avoid unintended negative impacts or to "do no harm" in such situations. Though they encourage taking the local context as a starting point and not trying to respond to all fragile states with a single blueprint approach, they also emphasise the importance of supporting statebuilding in order to support long term peace and development.

Progress

We are now in the process of monitoring how the new guidelines are being applied, developing further guidance on how they should be applied in practice, and supporting international dialogue around supporting peace and statebuilding.
Following our piloting of the principles in six countries, and the results of a 2009 survey to monitor their application at country level, it is clear that the international community is finding it harder to apply some of the principles than others (Figure 1).

[352] The fragile states principles can be accessed at: http://www.oecd.org/dataoecd/61/45/38368714.pdf

Figure 1: Progress in applying the fragile states principles at country level, according to the 2009 survey.



We are now in the process of collecting data for the latest survey on application of the fragile states principles and the results will be available later this year – combined with the results of the third survey monitoring the Paris Declaration in one single global monitoring report. Some preliminary trends are already emerging, including:

- Applying the principles of doing no harm and avoiding pockets of exclusion still seem to remain big challenges. Uneven geographical distribution of aid within countries is still a concern.
- Donors are doing better at aligning with local priorities in each context and there has been some growth in the use of harmonised funding channels, at least at the national level. But the medium term predictability of financial support has not increased.

In addition to the survey to monitor progress, our main efforts in supporting the application of the principles have been to (i) **develop guidance** for specific areas and (ii) to support international dialogue in this area. For example, we have produced policy guidance on supporting statebuilding in situations of conflict and fragility,[353] and the OECD DAC Handbook on security system reform.[354] The **International Dialogue on Peacebuilding and Statebuilding** held a second high level meeting Monrovia in June 2011. This dialogue is

[353] This policy guidance can be downloaded at: http://www.oecd.org/document/12/0,3746,en_2649_33721_46623180_1_1_1_1,00.html
[354] This handbook can be downloaded at: http://www.oecd.org/dataoecd/43/25/38406485.pdf

a forum for an open and frank exchange with the aim of improving peacebuilding and statebuilding efforts in fragile and conflict-affected situations. Currently, more than 40 development partners, international organisations and governments experiencing conflict and/or fragility are participating in the Dialogue. The ultimate aim is to improve the effectiveness of efforts to support peace and development.

3. Allocating Aid for greater effectiveness: the aid orphan problem

Aid allocations vary significantly from one country to another and the current extent of variation is neither equitable nor efficient. For example, in 2010 Rwanda received USD 100 per capita while Guinea received USD 20 per capita. While just using a per capita measure does not identify the level of need or ability to use aid, the starkness of these basic differences is in itself illustrative. It also raises the questions about whether aid is being allocated to address needs, to maximise effectiveness or for other more opaque reasons.

The phenomenon of under-aided low income countries, commonly referred to as "aid orphans" is the result of a **lack of co-ordination** amongst different players within the current global development co-operation system. Without impinging on each donor's right to determine its own allocations, it is, however, useful to examine how to increase the efficiency of global aid allocations, in particular to address systemic gaps such as the existence of critically under-aided low income countries. The debate around this problem is set out in a policy brief we issued two years ago entitled Aid Orphans: Whose responsibility?[355]

In fact, robustly identifying which countries are under-aided and require or could make use of more aid is in itself not straightforward. Criteria for allocating aid might include, for example, levels of poverty, fragility or government performance in using aid. Analysis according to different criteria produces a different list of under-aided countries. To make the analysis more robust, we have combined five approaches to produce a list of countries that are consistently identified as under-aided. Those countries which show up as under-aided according to two or more approaches are included on a so-called "**aid orphans watch list**". Countries on the watch list should not necessarily receive a sudden scale up of assistance. Nevertheless, appearing on a watch list would signal the need for a careful look at join discussion that would also take account of other relevant factors, such as severe governance or other absorptive capacity constraints. The majority of the countries on the "watch list" are (i) fragile states (ii) amongst the world's least developed countries and (iii) in Sub-Saharan Africa.

It is worth noting that the UK has done more than many of its peers to set out clear criteria for how it allocates its bilateral aid, looking at proxies of need and potential performance as well as trying to respond to the government's key policy and geographical priorities. While arguments can be made for and against the criteria used, the attempt to be transparent about what drives allocations should be acknowledged.

June 2011

[355] The policy brief is available at: http://www.oecd.org/dataoecd/14/34/43853485.pdf

Overseas Development Institute—Written evidence

Submission – led by Dr Alison Evans, Overseas Development Institute (ODI)

1. This evidence is submitted in response to a Call for Evidence by the House of Lords Select Committee on Economic Affairs. It covers "The Economic Impact and Effectiveness of Development Aid". The submission addresses only selected questions from the Call for Evidence, based on selected expertise and recent research at ODI. **The evidence presented reflects the views of particular ODI research staff and does not constitute an institutional position**.[356]

Linking Official Development Assistance and growth (Questions 1 and 2)

2. **It is generally accepted that evidence on the relationship between ODA and growth is context-dependent and that research findings on this are inconsistent.[357]** Analyses that categorically assert or reject a generalized link between ODA and growth are contested in the academic and policy literature. Nevertheless, as will be noted below, there are conditions at country level under which ODA is observed to contribute positively to improved economic development.

3. **Aid alone has not been shown as a significant driver of growth.** For example, countries emerging from conflict often experience surges in ODA and subsequently achieve rapid growth. Attributing that post-conflict growth directly to ODA is not possible given the variety of other contributing factors. Similarly, in South Korea and Botswana in the 1970s aid surges and growth coincided, but it is not possible to prove that this can be attributed to ODA.

4. **However, ODA may support growth in specific circumstances.** Studies that focus specifically on ODA investments that aim to facilitate growth, which includes that invested in infrastructure and productive sectors (such as Aid for Trade), show some notable positive correlations[358]. In addition, it is plausible that ODA investment in the social sectors is linked to growth in the medium-long term as a result of improvements in human capability and productivity in recipient countries.

5. **ODA can act as a catalyst for growth by contributing to or stimulating other drivers.[359]** It is not possible to isolate the extent to which positive links between short term growth and ODA can be attributed to UK ODA. If UK ODA is seen as a catalyst we can identify the impact of that aid on key drivers of growth – policies, institutions, economic and social infrastructure. The possible impact of the UK on some of the broader regional and global drivers of growth is beyond the scope of this submission.

The impact of ODA on private investment (Question 8)

6. **There is no systematic evidence to establish whether ODA inhibits private sector investment.** Since ODA can increase public investments, there is significant scope for it to complement private investment and possibly to produce a "crowding in"

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[356] This submission has been put together by Dr Alison Evans, Marcus Manuel, Jonathan Glennie, Claire Melamed, Pedro Martins, Matthew Geddes and Gina Bergh. All contributors are research staff at ODI. However the submission does not in any way represent an 'ODI view' on these matters and reflects the positions of individual research staff.

[357] Refer to Rajan and Subramanian in 2005, who find 'little robust evidence of a positive (or negative) relationship between aid inflows to a country and its economic growth.' In *Aid and Growth: What does the cross-country evidence really show?*

[358] See Clemens et. al. 'Counting Chickens When They Hatch: The Short-term Effect of Aid on Growth' (2004)

[359] See Kharas or DPS: http://www.developmentprogress.org/sites/default/files/dps_synth_report_-_digital.pdf.

effect e.g. where private investment is keen to go but unable to because of inadequate infrastructure or weak regulation. ODA tends to finance public goods and does not compete for resources in poor countries which have spare human capacity and underemployed resources. Some evidence of crowding-out has been linked to ‘dutch disease’ effects where inflows of aid result in a real exchange rate appreciation and an implicit ‘tax’ on exports. However such effects can be managed with sound policies and are not inevitable.

7. **ODA has been successful in removing micro-level constraints to private investment.** For example, US ODA played a key role in Ghana’s rapid agricultural growth by sharing technology and helping to establish cold storage facilities near the airport. ODA has also had a positive effect on the macroeconomic stabilisation of developing countries, particularly across much of Africa during the 1990s. This has in part translated into the increased interest of private investors in Africa over that past 5 years.

8. **ODA can facilitate private sector investment if invested to establish the institutions, legal basis and infrastructure needed for private investment.** For instance, it can do this by funding capacity building and investing in trading ports. In Southern Africa DFID supports the North South Corridor programme led by the Common Market for East and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC). This saw the international community pledge $1.2 billion for trade infrastructure and facilitation along one of Africa's oldest and busiest trading routes[360]. UK support to the Malawian cotton sector (through DFID in 2003-5) aimed to improve production by working with producers in-country. A DFID contribution of £295,000 with a £1.3 million matching public sector investment by the government of Malawi resulted in 25,000 additional seasonal employees being employed in the sector due to long term increased cotton production. The programme incentivised 250,000 farmers to grow cotton, leading to major and lasting industry growth[361].

9. **There is a role for external actors, including donors, in facilitating private investment in Africa.** Infrastructure deals requiring foreign investment increasingly involve resource processing in addition to resource extraction, with the proportion of deals of this nature increasing by an estimated 25 times since the 1990s[362]. In 2010 government and private sources investment in Africa was $72 billion, and private sector investment in infrastructure in Africa is 13% of the emerging market total, up from 7% in 2000. Despite this investment promise, Africa faces extensive unmet needs in the provision of power, water, and transport, which require an estimated $46 billion of additional spending annually[363].

Learning lessons from countries that have ‘graduated’ from ODA reliance (Question 3)

10. **ODI research on MDG progress shows that ODA is rarely the leading factor in countries ‘graduating’ from aid.** For aid to facilitate lasting change in recipient countries, it must support endogenous change processes (“going with the grain”) by

360 For more information on the North-South Corridor: www.northsouthcorridor.org/
361 Humphrey & Navas-Aleman (2010)
362 McKinsey & Company (2010) *’Lions on the move: The progress and potential of African economies’*
363 McKinsey & Company (2010) *’Lions on the move: The progress and potential of African economies’*

playing a catalytic role.[364] Development challenges are complex. Differences in context mean it is not possible to design 'one size fits all' solutions.[365] Aid works in combination with other key drivers[366], such as pro-poor and pro-rural infrastructure investment, macroeconomic stability, and economic freedom for small-scale farmers and small and medium scale enterprises.

11. **However, development successes in Africa can in part be attributed to UK aid.** Cases such as Ghana demonstrate the gains that have been made towards 'graduating' from aid. It is clear from this case that although dependency on aid is a problem, aid can be part of the solution to dependency by focusing on attracting private investment and strengthening institutions for domestic resource mobilization and public finance management. Such cases demonstrate the importance of planning aid strategically for medium/long term development results and targeting an '*exit from aid*' strategy. In practice this means that aid agencies must adapt to include the private sector, focus their programming on the most catalytic investments and be ready to exit once the catalytic role of aid has been fulfilled.

12. **ODI research also highlights that countries graduate from aid once they are able to generate sufficient domestic resources.** This is dependent largely on internal policies and the external environment, and is not attributable to ODA -- although ODA can play an important role. In countries that have 'graduated' from reliance on external aid, aid itself has been negligible in this process. South Korea, for example, received 6 percent of GNI in aid in the 1960s and 2 percent in the 1970s. Botswana received an average of 17 percent aid/GNI in the 1960s and 1970s. Botswana's development came about as a result of its increased reliance on natural resources (diamonds) and South Korea through its effective industrialisation model which allowed it to become highly competitive in limited key sectors. These countries demonstrate that growth and fiscal independence was not linked to ODA. The most important drivers of success were, rather, country-led strengths: strong policy independence; strong institutions; and strong political leadership.

Factors that contribute to aid effectiveness and monitoring (Question 4)

13. **Assessment of aid effectiveness is dependent on the definition effectiveness and from whom it applies.** The most important factors to improving aid effectiveness are capable leadership at recipient country level and a minimum set of effective institutions, which include policy setting and budgeting as well as key delivery institutions. Domestic policy coherence is also important, but is frequently undermined by the conditions attached to aid. An example of policy coherence is the selection public investments funded by ODA that contribute to growth in line with a broader economic strategy. For instance, South Korea's policies to scale up ship-building.

14. **The principles on the aid delivery process put forward in the Paris Declaration continue to constitute relevant guidelines to making aid more effective.** Critical determinants of aid effectiveness (most of which are captured by the Paris Declaration) are that aid should be: country-led (note that conditionality has strong potential to reduce aid effectiveness); predictable; aligned with national strategies

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364 http://www.brookings-tsinghua.cn/~/media/Files/Press/Books/2011/catalyzingdevelopment/catalyzingdevelopment_chapter.pdf

365 http://aidwatchers.com/2011/01/aid-is-not-just-complicated-it%E2%80%99s-complex/

366 *Source:* Research at the university of Leiden: http://trackingdevelopment.net and similarly papers such as this: http://www2.vwl.wiso.uni-goettingen.de/courant-papers/CRC-PEG_DP_57.pdf

and complemented by availability of domestic resources and FDI. For aid to be catalytic (i.e. do more than just 'saving lives on the margins'), it must satisfy these criteria.

15. **Research points to a paradox between micro- and macro-level effectiveness.** A recent World Bank study found that 80-90% of aid at the individual project and programme level had been evaluated as effective, but that at the macro level there is much less evidence that aid is effective. These findings are not surprising given the fungibility of aid at the macro-level and the difficulty in measuring institutional and economy-wide impacts. It remains important, nevertheless, to seek a balance between aid investments that support long-term transformative change and the more alluring 'quick wins' in the short-term.

16. **Aid can be effective when it supplies much-needed resources to ease funding or capacity bottlenecks in recipient countries.** South Africa is an example of putting aid to good use in tackling bottlenecks. This case also highlights that there are much wider potential uses for aid than are commonly employed, and getting better at using aid for wider modalities is becoming increasingly necessary for strategic, long-term gains and eventual graduation from aid.

17. **Aid effectiveness is typically monitored according to specific outputs within the limitations of project parameters.** Projects are measured in isolation. This constitutes a weakness in how aid effectiveness has been monitored to date, because the broader perspective on aid effectiveness is ignored. Donor assessments need to move beyond aid effectiveness to focus on development effectiveness, questioning whether aid has complemented other country processes and whether the changes were sustainable.

The relationship between conditionality and aid effectiveness (Question 5)

18. **Conditionalities do not improve aid effectiveness nor do they 'buy' reform.** That many conditions of ODA have worked against aid effectiveness is supported by key points made in the Paris Declaration. Studies have also shown that if conditions do not align with recipient countries' aims and interests they will not follow them. Ex ante conditions do not buy a commitment to policy reform. Some ex-post performance based conditions, including human rights based conditions, have produced results but research and evaluation evidence also indicates that the tendency to overburden recipients with such conditions is entirely counterproductive. Aid effectiveness could be enhanced if countries take ownership of their own development strategy rather than donors relying on conditionality.

19. **The UK has sought to evolve its approach to conditionality.** In 2005, the UK government put forward an official statement that it would no longer support economic policy conditionalities through ODA and that it would seek to build greater compliance with reform through a partnership-based approach. The direction of travel was in line with the then UK government's position on supporting country ownership of the aid relationship. Since then there has been a weakening of this position and a return to the language of conditionality in UK aid. More evidence is needed to establish current practice in the UK.

ODA allocation and the MDGs (Question 6)

20. **Most aid agencies use the World Bank's resource allocation framework as the basis to decide on how to allocate ODA.** The standard allocation model [367] factors

[367] In Collier and Dollar's paper on the standard allocation model (*Aid Allocation and Poverty Reduction*)

in: population; GDP per capita; and how well aid has been used to date (among other factors). The basic premise of this model is that more aid should be given to the poorest countries and to where policy and institutional conditions are most favourable.

21. **Heavy reliance on the standard allocation model can prevent exploration of the potential for new aid allocation decisions.** Seen globally, aid is allocated unevenly across and within developing countries. Though it is necessary to allocate funds to the poorest countries, there are increasing tensions with where the poor are and where ODA is likely to be most effectively utilised. For instance, the vast majority of poor people now live in middle income countries. The very poorest live in fragile and/or conflict affected countries where the risks attached to delivering ODA are also greater.

22. **Data on aid to the social sectors (MDG priorities) indicates that aid allocation in these sectors was already increasing prior to the MDGs.** However, aid to primary education has increased exponentially since 2000, while aid to primary health and related services (especially through special vehicles like GAVI and GFATM) has continued to rise in line with MDG commitments.

23. **Research indicates that despite some clear successes of MDG-based allocations, it is important that allocations be context-specific.** A 'one size fits all' approach does not work. Rwanda provides evidence of this. Due largely to a significant push on HIV/AIDS, more donor resources were devoted to tackling HIV than on child health. Despite the Rwandan health strategy that clearly prioritised the need for child health investments, donors placed emphasis on HIV/AIDS. The result was that, not only did donor finance for HIV/AIDS overwhelm the Rwandan system it left support for child health under-funded.

24. **Some analysts argue that the social sector allocation bias resulting from the MDGs requires rethinking at this juncture.** Greater investment in the productive sectors could hold vast untapped potential for development progress, and particularly that which is more conducive to aid exit strategies through catalyzing sustainable growth. Therefore it is timely that there should be a rebalancing of allocation priorities based on more country-specific needs and analysis.

The utility of the 0.7% ODA target (Question 7)

25. **An ODA target of 0.7% GNI for OECD donors has excellent political value in garnering necessary aid volumes and in working towards aid burden-sharing among rich countries.** It has also raised consensus among donors that ODA levels should increase, whilst reassuring taxpayers that there is an upper limit to aid levels. The 0.7 target is a 40 year old target, however, and focuses on the responsibility of rich countries to support poor countries rather than what poor countries need to transform their economies, especially in a climate and natural resource constrained world.

26. **Increasingly the focus should move from ODA to development finance and a range of policy tools to support broad-based economic transformation.** Any new increases in aid volumes could be redefined as 'development finance' (as opposed to conventional bi- or multi-lateral aid), which could be used more innovatively for strategic and long-term development goals. For instance, one of the most pressing concerns for developing countries today is how to bring down prices of climate change adaptive technology for those countries in need of this. Another new priority is helping to find financing solutions to unaffordable vaccines and drugs so these can be made more widely available globally.

Increasing aid volumes and country capacity for absorption (Question 7)

27. **Absorption is not an absolute constraint in recipient countries, particularly in the medium-long term.** In those countries where absorption issues are more challenging the role of ODA should be to support institution-building and country capacity. Research on absorptive capacity has found that if aid is targeted to supply side investment, absorption is not problematic [368]. In other recent research[369], the aid absorption capacity of African governments is examined alongside spending, and in conclusion African governments are capable of absorbing aid.

28. **Research also suggests there is scope for aid flows at increased scale.** New aid modalities could support much-needed global public goods such as global fisheries protection, climate change adaptation technology, and agricultural research targeted at LDCs. There is considerable scope to spend more in MICs also, some of which have significant poverty levels along with existing high absorptive capacity e.g. India.

The interaction of UK aid and ODA with other sources of development finance (Question 9)

29. **There are substantial potential synergies between ODA and non-aid financial flows.** GAVI is a good example of a synergy between private and philanthropic sources and donors. There are a growing number of PPP-type mechanisms now in use, with donor grant finance being used to support more commercially driven finance in green-field investment areas such as new technology, medium-scale infrastructure investment and business/financial support to SMEs. In addition, forms of south-south and trilateral cooperation are emerging bringing together traditional and non-traditional donors in new style funding arrangements.

30. **Although the MDGs have provided a way of aligning different donors' interests to date, so-called 'new' donors are less concerned with the MDGs.** For example, the Chinese government views the MDGs as a largely Western agenda, and has been developing an independent aid policy direction. Brazil is acting in similar fashion and both countries are basing their priorities on their unique histories. The UK has been proactive in working with the Chinese in some cases, for instance in the DRC, where the UK supported the establishment of the necessary environmental regulations to allow China to finance new roads. Tensions have been overcome in some cases – for example the Chinese renegotiated and amended an infrastructure deal in DRC to make it compatible with the HIPC process. Brazil is strongly involved in trilateral cooperation (with the OECD, UN and other multilateral agencies), particularly on projects in Sub-Saharan Africa. The UK is in the process of negotiating trilateral agreements with Brazil, and it is an increasingly important actor – 81 countries worldwide benefit from Brazilian aid, and 38 of them are in Africa.

31. **The Paris Declaration tried to reduce the complexity of overseas aid through harmonisation, but has not succeeded.** It should be accepted that the international aid environment is inevitably complex. The increasing importance of philanthropic sources exacerbates this, but is unavoidable. Because of the complexity it is incumbent on recipient countries to manage external actors and flows, to understand the economic impacts of aid at country level, and to improve their transparency and accountability.

[368] Refers to Christopher Adam
[369] Journal of Development Studies – Pedro Martins

Emerging donors and their agendas are increasingly important and also need to be carefully managed.

The interaction between aid and security (Question 10)

32. **The aid-security nexus is a key challenge for development decision-making.** In Afghanistan, security funding was about 20 times that of aid. In Sierra Leone, funding for security during the peacekeeping phase was 5-10 times the aid level in the country. This highlights one of the greatest potential challenges to development in fragile and post-conflict states: different sources of funding (military and development) can result in a mismatch of funding. This translates most frequently to security sector spending being too high in relation to much lower spending on governance, legitimate political processes and courts. This issue is highlighted in the recent World Development Report.

33. **A priority is to integrate the development of the security forces parallel to the development of justice systems in post-conflict countries to date.**[370] This points to the need for donors to engage more in fragile states.

34. **There is a mismatch in risk-taking between donors and the military.** Donor countries are prepared to take military risks, but not to take similar risks in rebuilding the government through the use of government systems. Stronger commitment is needed to building government capacity in-country as the basis for future chances to exit from aid.

30 June 2011

[370] Ref: Alison Evans paper with OECD.

Overseas Development Institute—Oral evidence (QQ 82-121)

Evidence Session No. 4. *Heard in Public.* *Questions 82 - 121*

TUESDAY 12 JULY 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Forsyth of Drumlean
Baroness Kingsmill
Lord Lawson of Blaby
Lord Lipsey
Lord Hollick
Lord Moonie
Lord Smith of Clifton
Lord Shipley
Lord Tugendhat

Examination of Witnesses

Witnesses: **Dr Alison Evans**, Director of Programmes, Poverty and Public Policy, Overseas Development Institute, **Jonathan Glennie**, Research Fellow, Centre for Aid and Public Expenditure (ODI), and **Edward Hedger**, Senior Research Fellow, Centre for Aid and Public Expenditure (ODI).

Q82 The Chairman: Good afternoon and welcome to the Economic Affairs Committee. This is the fourth public hearing on this inquiry into the economic impact and effectiveness of development aid. You are very welcome. Thank you also for your written submission, which we have all had. We are most grateful for that. Could I ask you to make sure that you speak loud and clear for the webcast and the shorthand writers? Since there are three of you, we realise that you may all want to contribute to each question, but please do not feel that you have to. If you agree with the opening speaker, as I imagine you might coming from the same institution, you do not have to come in, but please do so if you want to add something. Would you like to make an opening statement or can we go straight to the questions?

Dr Alison Evans: We are happy to go straight to questions based on the written submission that we have already made.

The Chairman: We will, to some considerable extent, be following the submission as well. The first paragraph of your written evidence suggests that there is no clear evidence that aid helps economic growth in recipient countries. Is there a case for shifting the focus of aid programmes more towards encouraging growth, or should we accept that the aim of aid is to discharge rich countries' responsibility to provide support for poorer countries, as you have indicated somewhere else in your evidence?

Dr Alison Evans: If I may, I will take the first stab at that and give my colleagues an opportunity to add to what I say. At the Overseas Development Institute we do not take institutional positions, so you will often get a diversity of opinion, but we hope that with the evidence we have submitted you will at least have seen some synthesis of our views on a number of these very important questions.

In terms of the relationships between overseas development assistance and growth, we tried to communicate in the written evidence that these are highly inconclusive sets of relationships, or that the evidence around them is highly contested in the research literature in particular. There have been efforts over the past 30 or 40 years to try to bottom out a simple, straightforward relationship between inflows of development assistance and economic growth in developing countries. Those efforts have been considerably frustrated by model specification challenges, problems of time lags and, quite honestly, a lot of weaknesses within the data.

One thing to remember in trying to model the relationship between aid and growth is that, although we may have fairly good metrics for measuring growth, our metrics for measuring aid have only really been evolved and made more sophisticated in the past 10 years or so. Aid is a bundle of things. There is financial aid but there is also aid in the form of knowledge transfers and in-kind transfers, and capturing all that within a single money metric is quite difficult. However, even within the part of aid that is financial, it is delivered in many different forms and, again, trying to model that in a straightforward way has proved very difficult.

Our point about the relationship between aid and growth being somewhat inconclusive is not to suggest that there is no relationship; it is just that the research evidence is inconclusive in that respect. If one looks at a more micro level or country level, one can observe a whole variety of ways in which overseas development assistance can contribute to economic development more broadly, of which growth is one metric. We have outlined some examples of that in our submission.

As to whether aid should be directed more consciously to supporting economic growth, the answer is yes in some senses. I think that we made a number of comments in the submission about the fact that over the generations there have been different views about where aid should be directed. There was certainly a period, particularly at the end of the 1990s and the 2000s, in which a lot of development assistance went towards supporting human capital development, very much in line with the millennium development goals and so forth. At that time, there was a shift away from what one would generally call growth-enhancing or growth-inducing sectors—agriculture being one example, and to some extent hard infrastructure. That trend has been reversed somewhat since the mid-2000s as the international community has taken account of the fact that investments in human capital development, while absolutely critical, need to be accompanied by public investment, supported by aid, in infrastructure development in particular, which is growth-enhancing in the short to medium term. I do not think that it is an either/or situation. We see a landscape which has been changing. The broad global relationship between aid and growth will probably remain forever inconclusive, but if you come down to specific contexts, you can begin to see some important relationships between the allocation of overseas development assistance and its economic impact.

Q83 Lord Lipsey: Can I ask a supplementary question? Very important to the inquiry that we are on is the question of whether aid improves growth. It may have other purposes but that is rather fundamental. Mr Finn Tarp submitted evidence to us on 30 June in which he claimed that 129 out of 131 studies showed either a positive impact on growth or no statistically significant answer. Is there a difference of opinion between you and that authority?

Dr Alison Evans: There is a difference of opinion in the field in general. Finn Tarp, who is a much respected researcher in this regard, has in many ways been a bit of a pioneer in trying to improve the model specification to try to tease out the relationships between aid and growth and he has made a lot of headway. Equally, many researchers have tried to do that in different ways with different model specifications but those have come up as largely inconclusive. He has been more thorough than probably anyone in trying to review the body of evidence and he has begun to innovate in interesting ways. Our point was not that there is no relationship; we were very clear in saying that it is inconclusive. I think that even Professor Tarp would have to say that a lot of the studies that he has reviewed would suggest that it is inconclusive.

Q84 Baroness Kingsmill: In the light of the inconclusivity of its outcomes, where would you say that aid has the largest effect? Where would it have a significant effect?

Dr Alison Evans: I reiterate that the question was specifically about the relationship between aid and growth. The economic impact of aid can be felt through a variety of transmission mechanisms. Aid has been demonstrated to have a strong catalytic and facilitative effect in terms of a whole number of things that help to generate growth, but we should remember that growth is an outcome, and there are lots of steps to achieving growth. If you work back from that, I think that we are, if you like, beginning to close down this inconclusivity and find much more crunchy and obvious relationships.

Q85 Baroness Kingsmill: Other witnesses have suggested to us that the relief of poverty should be, and is, the main focus of development aid, and that we—wealthy westerners that we are—see that in terms of promoting economic growth. Would you say that there is something wrong with that particular equation?

Dr Alison Evans: I am happy to let my colleagues in on this but I would take the very clear view that you cannot achieve long-term poverty reduction without economic growth. However, there are other things that one needs in place in addition to economic growth, and human capital development is clearly one of those.

Q86 Baroness Kingsmill: I am just teasing this out for my own understanding, because it is not a field in which I have an enormous amount of expertise. Do you think that an organisation or a department such as DfID is the best institution to dispense this kind of aid?

Dr Alison Evans: Aid that is contributing towards growth?

Baroness Kingsmill: Yes.

Dr Alison Evans: Indeed, particularly given the logic that growth is one of the key critical elements of long-term poverty reduction. If one simply looks at the track record of developing nations, particularly over the past two decades, then we have seen some really dramatic turnarounds in the economic fortunes of quite a large number of developing nations, growth has been an absolutely critical part of that turnaround. That is true today in a number of sub-Saharan countries that even a decade ago we were arguing were stagnant or not going anywhere. Now, along with this growth are coming reductions in absolute poverty. So, to the extent that DfID is looking, through its mission, to reduce poverty in the developing world, it needs to be making a strong contribution to the drivers of growth.

Q87 Baroness Kingsmill: I suppose that what I am saying is that there is an argument that says that a government department is not necessarily the best place to bring about economic growth. Possibly the private sector is better placed to do that.

Dr Alison Evans: I will finish now and let my colleagues come in but the evidence that we are certainly fairly comfortable with shows a strong complementarity between public and private in terms of stimulating economic growth. In developing countries where there are major deficits in terms of public goods, many of which are growth-related, such as infrastructure and even regulatory capacity, one needs public investment. Therefore, the role of DfID as a public agency dispensing development assistance is crucial.

Jonathan Glennie: I agree pretty much with what Alison has said. One of the problems is the generality of the question. A lot of the analysis that Finn Tarp would have looked at tries to see where there is a link between aid and growth across a large number of countries. It is quite plausible that in one country aid has contributed to growth and in another country it has not contributed at all or has done harm, which is also possible.

Q88 Baroness Kingsmill: Tell us what the difference is.

Jonathan Glennie: Unfortunately, the world is extremely complicated. In some countries, the nationalisation of X industry, say, will lead to growth, whereas in another country privatisation might have that effect. It is very difficult to find great facts that are true across the world, whose diversity is very strong.

I want to throw in a couple of other points. Theoretically, aid that is focused on infrastructure, as Alison said, and supporting businesses is likely to lead to growth in the shorter term. Aid that is focused on health and education—urgent needs—is theoretically less likely to lead to growth in the short term because you are focusing on babies surviving. In the long term, a healthy and educated workforce is absolutely fundamental to growth, so I would not separate the social sectors as a kind of non-growth activity. They are absolutely fundamental to a vibrant private sector and growth in society.

The other element is institutions. They are increasingly an element that we have to take into account when we look at the role that aid plays. Sometimes they have been seen as a purely economic or financial input, but the development of institutions is a key part of the development. It is a question not just of responding to urgent needs but of helping countries to develop strong institutions. Nowadays, that is a vital plank of almost all development theory, partly in recognition of the fact that in the 1980s and 1990s there was possibly not enough focus on those institutions. Again, when aid supports institutions, it hopefully supports growth and poverty reduction in the longer term, although that may not come out in the short-term statistics.

Q89 Lord Lawson of Blaby: I strongly agree with Dr Evans that long-term poverty reduction depends on economic growth. Therefore, it is right for this Committee to focus to a considerable extent on economic growth.

As for the variety of the so-called evidential stuff on different countries, I must say that, listening to what has been said, there is a grave danger of falling into the fallacy of post hoc ergo propter hoc. It is tricky. It is very difficult to analyse the consequences of aid. I was interested, too, in the fact that your colleague mentioned that there are occasions when aid can do harm. That is clearly so. We had good evidence at last week's session of this Committee from Sir Edward Clay, in particular, about the corruption that he saw in Kenya. However, Kenya is not unique. Although it may be a bad case, it is certainly not unique.

I wondered whether, since you are experts in this field, you could point us to the best evidence that there has been of the harm done by aid, whether it is corruption or aid dependency or whether it is bringing about the imbalance that occurs because it is Government-to-Government aid between the public sector or the government sector and the private sector in the countries concerned. It would be useful for us to have that kind of evidence. Because you are experts, you will be more aware than we are of the evidence on both sides. My impression is that the aid establishment, of which I suppose you are a part, is very concerned to look for evidence that seems to support the beneficial effects of aid. However, we have to be completely dispassionate and look at both sides of the picture.

Jonathan Glennie: The first thing I would say is that there is evidence that aid can do harm, but when the aid establishment, or those of us who really believe in the importance of aid, start mentioning that, the danger is that it is then used to undermine the case for giving it. That is as fallacious as suggesting that, because some hospitals do not work, we should cut funding to hospitals or that, because some social services are disastrous, we should cut funding to social services. That is not a sensible argument. It is an argument for analysing the situation very clearly and making it better. That is why it is important that the aid establishment is critical of aid when it is appropriate to be so.

I have done most work looking at the holistic impacts of aid on institutions over a long period. Examples of where aid has worked incredibly well are, say, Korea or Botswana in the 1970s. Quite a large amount of aid was involved but over a short amount of time in countries that knew what they were doing with it. I was just chatting about that with Alison. She thinks that Korea had an exit strategy—it knew what it was planning with that aid.

There is a big difference between that situation and countries which have received very large amounts of aid—say, 15% to 25% of GDP—over 20 to 30 years. The impact that that has on institutions and on the accountability of Government to its citizens, rather than to very large-scale donors, is, in the long term, something to be concerned about. There are also very positive impacts of that same aid, in that it responds to urgent needs, but at the same time it develops an element of dependency that needs to be addressed in the long term.

The other major negative impact of aid in my view—a view not shared by all my colleagues at the ODI—is that, during the 1980s and 1990s especially, there were very strong ideological economic policy conditions attached to aid in many countries. Countries that were dependent on aid basically had to implement certain economic policies at the behest of the donors, and those policies were often wrong. The macroeconomic stability policies were broadly right but a lot of the micro-level policies were wrong, and that is becoming clear now. More importantly, the impact that it had meant that the democratic accountability of those Governments to citizens and the development of the state post-colonialism—and the important process that that was going through in the 1960s and 1970s—were undermined. Again, the more I work on this, the harder I find it to give general global answers. However, there is no doubt that in some countries that is a concern. You can see it now when you speak to even highly aid-dependent countries such as Sierra Leone. They are looking at the Rwandas, the Vietnams and the Ghanas of this world that are being much stronger in saying, "Yes, we need aid. Of course we do, but in the not-too-distant future we're planning an exit from aid because we recognise that it is not sustainable to continue in this relationship." I think that Britain and other countries have to start thinking about how development finance should be used to support global public goods, rather than transferring them to other countries.

Q90 Lord Hollick: You lay great emphasis on the inconclusive nature of the evidence. Your colleague has talked about the complexity of this whole area and the fact that one shoe does not fit all. In your view, does DfID have the right skills and enough of the right skills to navigate through this complex, so that we can in fact get the best possible outcome in terms of aid promoting economic growth in a particular country?

Dr Alison Evans: I think that that is a very interesting question. Again, it is a little hard to have a general view. DfID has been no different from many other agencies within this business in terms of being a little bit prone to the fads and fashions, as it were, of where they skill up and where they deskill, relating to what is hot and what is not within how we understand what drives development. It is certainly the case that DfID, as a bilateral development agency, is regarded among its peers as being in many ways world-class. Not only has it made a very strong and sustained commitment to poverty reduction as its overriding mission but it has also retained a lot of in-house technical capacity, which has not necessarily been the case in a lot of other agencies, which tend to have invested even more in what you might call general process skills rather than technical skills. That is not to say that that balance is completely right. With the need to engage much more closely with private sector partners and to think about development assistance as being a catalyst for growth, you need to make sure that you have high-quality technical skills that are able to execute against those agendas. I think that DfID is currently in a phase of trying to rebuild its complement of skills under the new Government's direction. A new private sector department is looking to invest specifically in skills sets that are appropriate for supporting the development of private sector capacity in developing countries and for working more closely with business. That requires a certain level of experience and technical knowledge and they are investing in that now. Compared with others within the field—the multilaterals aside, of course, who have much more of all these skills—they have a good complement of skills in the area of growth and particularly private sector development.

Q91 Lord Forsyth of Drumlean: Can I just go back to what Mr Glennie was saying? He gave the example of Korea and ending the cycle of dependency and he made the point about ideology in the 1980s and 1990s, with people having a particular view of economic policy. Does this not point to helping those countries through a variety of disparate organisations rather than Governments, who on both sides are more likely to have an agenda, whether it is a right or a wrong agenda? Therefore, would it not be more effective if the support that countries received came through private agencies and charities rather than necessarily through Governments, who will always have a particular agenda?

Jonathan Glennie: I wish that there was an answer. It is certainly true, and we should recognise it, that donor countries have an agenda. Whenever we think about China and India in Africa, it is always at the top of our mind that they have an agenda—of course they do. But sometimes we forget that we have an agenda as well—and of course we do. It is a really important point. But NGOs also have agendas in general. Some of the most powerful NGOs are run by single individuals rather than, say, the public. Your Oxfams or your Christian Aids of course have agendas, but at least they have large-scale support.

Lord Forsyth of Drumlean: But they are diverse and there are lots of them.

Jonathan Glennie: There are a lot of them. I agree with your general point that a diversity of input is sensible. The good news is that economic growth has been taking off in this last decade in a way that we have not seen, even in the poorest countries, for some time. You will know that low-income countries are emerging to become middle-income countries. That is one of the trends of the last 10 years. In that context, it is the political issues in a country rather than so much the problem of growth that needs to be addressed. Therefore, supporting civil society to insist on its rights is a very sensible thing for, let us say, outsiders to get engaged with. Although I am highly aware of the complex mixed motives of donor Governments when they get involved in a foreign country, I still do not think that it would be a better scenario if they were not involved. There are just as many brilliant examples of it working as there are of it not working. It is just a complex world. I think that, in general, moving things towards a UN-based focus would broadly be a good thing.

Q92 Lord Smith of Clifton: We have heard some evidence that just too many agencies are giving aid; the absorption capacity of a nation becomes overstretched and much too much resource is spent on dealing with the donors. You were saying towards the end that we should have a more United Nations focus, which is presumably to bring down the number of people involved, yet at the same time you were saying that it is a good thing to have a multiplicity of donors all over the place. How do we square this?

Jonathan Glennie: I am not sure that there is an easy squaring. What I meant is that the UN as a body has less clear interests than the OECD as a body or a particular donor, say the US or Britain.

Dr Alison Evans: Perhaps I may come in on this. There is an important point here. There is a lot of evidence to show that fragmented development assistance can be some of the worst kind, in that you have multiple players trying to deliver multiple forms of development assistance, whether it is private, NGO or public. For a receiving country, that can be its worst nightmare. The answer is very often not to try to eliminate, as it were, the different flows but to strengthen the hand of receiving countries to be able to co-ordinate this development assistance in the best possible way behind their own planning and budgeting processes and so forth. So it is about strengthening the ability of recipient countries to be good co-ordinators and managers of the development assistance that is arriving, whether it is coming through non-governmental channels or governmental channels. To be fair, DfID has been a leader in arguing that case and has been very successful in many ways in arguing that that is where the emphasis should be placed—hence its emphasis on strengthening public financial management systems of Governments and so forth to allow that to happen.

Edward Hedger: Two or three of these questions pick up this common theme about a nature and form of engagement that is about empowering particularly the Governments in many of these countries, which are in some cases if not explicitly fragile then relatively fragile. These are countries where that citizen-state contract does not exist and where the complete avoidance of Government as a provider of services risks failing to strengthen that link. It is about the nature of engagement and looking at how that accountability can be built domestically and it is about avoiding an excess of skewing the accountability outwards and beyond to external partners, which can last only as long as those external incentives exist.

The other point is just a small one on the question of skills. This is partly about whether there is the right complement of skills but it is also about whether there is the right deployment of skills. One thing that DfID has done well is to look at a much more localised engagement of people on the ground. One of the lessons that we have learnt time and again is that short-term missions and short-term deployment of staff without familiarity with context do not lend themselves to good policy advice and good engagement. The role of the donor agency is not just to provide financial assistance; it is also about engagement in policy questions on other sorts of things. One piece of evidence that we have that speaks to this quite strongly was evaluation of some of the engagement in the Latin American programme. In that case, DfID in particular but also others distinguished the aid relationship from the advisory relationship. They were looking at strengthening advice on government policy and at networking and brokering around assistance-type relationships without the prospect of financial assistance behind that. That was very effective because there were skilled communicators and facilitators around that. So it is a complementary skills set and not just a substitutive one for those specialisations, but I think that both are necessary and some in-country deployment is also required.

Q93 Lord Tugendhat: One of the most attractive features of your evidence is the way in which you express doubt in areas where doubt is the appropriate sentiment to express. You say, "There is no systematic evidence to establish whether ODA inhibits private sector investment." But does that mean that the private sector in recipient countries chases the aid rather than making the best investments or do aid programmes recruit the most talented people away from the private sector? Again, you express uncertainty and I would be grateful for your comments.

Dr Alison Evans: Perhaps I may try to answer that initially. I think that this is an area where, quite frankly, we could all do a lot more work. There is certainly an established body of empirical evidence of a fairly global nature, which was very current in the 1980s in particular. It argued that aid supports public consumption in developing countries and, through the macroeconomic identities, therefore reduces the scope for private investment. Actually, I think that we have moved on beyond that point. There is no single view in this regard, but I think that there is now an increasing amount of openness to the possibility that aid can play a supportive, facilitative role in encouraging private sector investment. There are some good examples of that, and I hope that we highlighted a few, particularly in establishing transport corridors and in trade facilitation—the aid for trade business—which has started to really engage with this issue of supporting and encouraging private sector investment.

However, it would be completely remiss of me to suggest that the evidence for a very positive sum relationship is overwhelming. There are cases where certainly large, often multilateral aid investments in countries have more or less crowded out the possibility for small-scale private investment to take off. I am thinking particularly of the 1980s and 1990s. There is much less of that now, but there are probably some examples.

Just to go back to Lord Lawson's point about the evidence of aid doing harm, there has been a lot of evaluative evidence over the years that suggests places where aid has simply not done what it could or should have done—or, in some cases, has done worse than that. That is bound up in the evaluation archives of major development agencies—it is there but it is hidden away in those archives.

In terms of whether private sector investment chases the aid, I am not entirely sure that I fully understand that. It is certainly the case that there was a time when, particularly for sub-Saharan African countries, unless a country had an IMF programme and probably a World Bank loan, a lot of foreign direct investors were simply not interested. We are in a completely different space now. In fact, investors are falling over themselves to find ways of moving into a large number of fast-growing sub-Saharan African countries now. It certainly is not the case that the presence of aid is the requirement in order to bring in that investment. I think that we are in a very different territory today.

Skills are an area where I would express most anxiety. I think that there have been some quite egregious examples of young talent being, if you like, swept up to work on aid-related projects within Governments, because that is where the incentives are and that is where the salaries have been higher. That has left a much diminished pool for domestic business and the private sector. There have certainly been some quite egregious examples of that in the past. Donors have had to sit down and assess whether they are paying salaries that are out of kilter with local wages and whether they have been putting incentive schemes in place that are unhelpful. In some cases, they have had to agree among themselves that they are not going to do that, in order to avoid this displacement of human resources into aid-related activities. Again, I think that we are probably through the worst of that, but it certainly has not been eliminated from the way in which donors operate.

Lord Tugendhat: It is a phenomenon a bit like so many bright people from universities all going to work in investment banks before 2008.

Edward Hedger: It is also a particular issue in some of the fragile states, where capacity has already leached from those countries. It is not a challenge merely for the private sector. Public administration is suffering as a consequence of this. It is partly the privileging of donors who are able to pay more to take talented people on to their staff to engage—that is the question of depleting that resource and the availability of that resource—but it is equally about the incentives that that then creates for those people on much lower salaries who remain either in the public sector or in fledgling private sector activity. Those people see sometimes less qualified individuals, who happen to have the right language skill but not the right expertise or training, or who happen to have some international connection, having access to opportunities. That has quite strong distorting effects.

Q94 Baroness Kingsmill: A thought struck me during your evidence. Do you think that donor countries are entitled to expect a return on their "investment", if you like, in these countries?

Dr Alison Evans: I think that the return that they are certainly entitled to is a return in terms of development outcomes, because clearly that is, in my view, the nature of the enterprise in which they are engaging through official development assistance.

Q95 Baroness Kingsmill: I look at countries such as China, which are putting very large sums of money into Africa, clearly with a view to extracting quite a lot from them as well. The scale of that contribution is enormous and I am wondering whether that contributes more to development than the aid that has no strings attached other than the sort of glow of satisfaction that one gets from seeing a country develop. I know that I am saying something a bit controversial, but I want you to tackle it, if you could.

Dr Alison Evans: Let us tease that out, as I am sure that we all have a view on that. The first thing to say is that we simply do not know yet; it is too early to know what the contribution of the investments from emerging powers, particularly but not exclusively in Africa, is yielding in terms of development down the road. I think that we can make a pretty good guess that we are going to see some kind of growth relationship at some point between investment in infrastructure, as we talked about before, and improvements in growth.

It is important to unpack a little some of the motives, particularly around the Chinese development corporation. It certainly has a strong commercial interest, but it also has a strong glow of solidarity about it and I do not think that we should lose sight of that. In Chinese terms, this is their version of charitable purpose, but they frame it very much in a language of mutual reciprocity—this is about solidarity. They see themselves as partners of these countries, certainly not as donors. They have a particular view on the nature of the relationship and that then frames the way in which the co-operation is designed and delivered. Quite a lot of that is, as you say, with an explicit eye to a return, in terms of access to critical resources or particular markets. But it is also the case that Chinese investments are very complex. They come in multiple forms and are handled by multiple agencies within the Chinese state. Again, interpreting this as a single self-interested transfer is dangerously stereotypical. We need to understand much more about the way in which that self-interest is deployed.

India does its development assistance differently again. Brazil is becoming quite an important player—it has a $30 million a year bilateral aid programme, which it is looking to grow. It, too, has a language of joint diplomacy and solidarity. So it is not as though this assistance is purely commercial. They are certainly looking to build relationships with other southern nations in the spirit of the G77, which is those countries that have been and are recipients of development assistance.

Q96 Baroness Kingsmill: But they do not seem to be doing it for the warm glow that we are doing it for.

Dr Alison Evans: I do not know whether that is the case or not.

Edward Hedger: With regard to another group of these actors—some of the Arab donors—the Saudi development fund and aid programme would argue that some of that sense of solidarity translates into this. Also, there is the fundamental belief in, and their own experience of, the principles of education, which they hold strongly. The nature of the regional neighbourhood also clearly plays a role. To build on what Alison says, in my experience the critique of those country donors that this is somehow an inferior quality of aid to that given by OECD DAC countries is completely rejected on the basis that they see fewer strings attached. Therefore, if there is an investment and that investment can demonstrate that it is likely to make a return, they would support it in some of the large infrastructural projects. Critiques could be mounted but their argument would be that this is much more explicitly pro-growth-directed aid. The second point that I would make—

Q97 Baroness Kingsmill: Sorry, but on that point, have any comparative studies been made?

Edward Hedger: There is very little, because some of the data is less public and less transparent, which, particularly in that group of donors, is partly due to the nature of the activity.

Jonathan Glennie: The report *African Economic Outlook* by the OECD and the African Development Bank shows that between 2005 and 2009 DAC donors spent 65% of aid in Africa on social sectors, while China was spending 61% globally, not in Africa—they are not directly relatable—on economic infrastructure. That is quite significant. It is why some people argue that there is quite a large amount of complementarity, hopefully.

Q98 Lord Lawson of Blaby: But the truth of the matter is that—and this is not disreputable—China is politically motivated. China is the new imperial power in sub-Saharan Africa. In a sense, we can empathise with that, because we were once the leading imperial power in sub-Saharan Africa. China has its own objectives, which are to secure access to raw materials for its future growth. In order to have the use of these raw materials, it needs an adequate infrastructure in these countries. It has a very clear political motivation and I am not sure that the sort of analyses that we have been talking about bring that out very fully.

Dr Alison Evans: I would be very nervous about using language such as "new imperial power". I do not think that there is a lot of evidence that China has quite the same ambitions as those of previous eras. Nevertheless, there is a political economic motivation to its investment—there is no question about that. There are some thorough pieces of work that have tried to deconstruct Chinese aid in Africa and we would be very happy to furnish references to those, but I am afraid that what you will find is that it is incredibly complex—you cannot straightforwardly read off any one motivation. But it is also worth noting that the Chinese five-year plan that has just been published has an important shift in language around its external affairs in this regard. It talks for the first time about development co-operation. It does not just use the language of investment in Africa for the purposes of fuelling the economic boom. That is a change in language.

Q99 Lord Hollick: Without wishing to revisit our imperial past, do you think that there is something we can learn from the approach of China and Brazil, which is about mutuality and partnership and which is about more than getting a warm glow but actually getting some tangible benefit from substantial investment in a growing economy?

Jonathan Glennie: Yes, I do. I cannot resist saying that it would be wrong to accuse America, for instance—it is always easier to judge other countries rather than our own—of not having political interests in Latin America in the billions that it has spent on aid there since the 1960s, 1970s and 1980s, or France of not having political and economic interests in francophone Africa when it was spending aid there. By implication, the UK also has quite clear political interests with our aid. There is certainly the warm glow—that is one way of putting it—but the emergence of new donors is helpful, because it helps us to understand the deeply political motivations of aid giving as well as the humanitarian and moral motivations of aid giving. I agree with Alison that China's motives are both humanitarian—it is the third biggest food donor in the world now—and clearly political and economic. There are 300 million or 400 million people in China who still live on below a dollar a day, so China has every reason to want to develop trade relations. As the sixth or seventh richest country in the world, we do not have the same right to demand a return as I think the Chinese and the Indians do.

The question was whether we can learn from the mutuality of the Chinese. I think that we can. If you speak to the people managing aid in African countries, they will talk about the ease of doing business with Chinese donors as opposed to western donors, who tend to insist on a lot more. I urge an element of caution on them because there are reasons why western aid donors with a lot of experience—and I am critical of a lot of conditionality—insist on doing things properly: accounting properly, doing a social impact assessment before spending money and doing an environmental impact assessment before building a road or a pipeline. At the same time as we need to look at the new ways of giving money and to learn how to change the way in which we operate, we also have to share the vast experience that very serious people have from 50 years of aid giving and say, "Not all easy money is good money."

Q100 Lord Shipley: Can I take you back to the issue of aid that produces growth? We talked about a number of countries, but does the aid that they are giving deliver aid in ways that ours does not? I have been intrigued by four separate statements that you have made in the last three-quarters of an hour or so. I would like to quote them back to you, if I may, because I would like to be clearer about what you think the UK should be doing in terms of its aid. First, you said that some low-income countries are becoming middle-income countries. Quite separately, before that you said that aid leads to growth in some countries but not in others. You said at the start that there is a lack of evidence overall that aid leads to growth. You also said that there is evidence that in some places aid has done damage. I would love to know what conclusions you think we should draw from that in the context of the aid that we are giving but also in the context of the aid that other countries are giving. In other words, can we learn things from them in terms of how aid produces growth?

Dr Alison Evans: The hard reality is that we stand by each of those full statements. They are all correct in themselves, but we are also trying to point you in the direction of going down a few levels in terms of the unit of account. If we talk about these things globally, we end up with some very contradictory stories. The relationship between aid and growth in the literature is pretty inconclusive. You can play with a model but it does not necessarily produce a strong, robust result everywhere. That does not mean that it does not produce it anywhere but nor does it mean that it does not hold at lower levels. There is something in this field called the micro/macro paradox, which is an old stylised phenomenon. You might be able to observe very strong relationships between aid and certain outcomes, including growth at a micro level, but you cannot aggregate them up. People have challenged that paradox but unfortunately it persists throughout the evidence. That is what we are dealing with.

In terms of whether there are things that can be learnt and whether the UK, in particular, needs to learn those things in order to be able to direct its development assistance more usefully towards growth, there have, for example, been very different practices over the past decade. If you look at the way in which the United States has delivered its development assistance, it has been much more targeted at certain growth-inducing sectors and areas of the economy. It has been much more active in supporting the private sector and small and medium-scale enterprise development, and in looking at regulatory issues. There is obviously quite a lot of work going on regarding trade initiatives and so on, and a lot can be learnt from that. The good thing about USAID is that it evaluates itself very closely, so there is quite a lot of evidence to show what works and what does not work. The World Bank has a lot of experience in this area. However, I think that DfID is immersed in all of that. It is very much a player and a leader in some of these areas, and it has a huge amount of its own experience to draw from. It would be fair to say that, in the past 10 years or so during the period in which the millennium development goals have been at the top of everyone's agenda, DfID, along with a lot of other OECD DAC donors—as indicated in the data that Jonathan gave—has invested a lot in social sector development. We would be the first to say that that has been a very good investment in the medium to long term. However, if you want short-term outcomes in terms of growth and prosperity in the here and now, you have to look for other investments. Infrastructure, the quality of the business environment, the investment climate, working more closely with small and medium-scale enterprises, and releasing financial constraints for small-scale entrepreneurs need to be part of the mix. DfID could do more and I think that it is looking to do more in that area.

Going back 20 years, you probably would have seen DfID—the ODA, as it was—doing more in those areas. The point is that the pendulum has swung. You asked us in the call for evidence whether the millennium development goals had in any sense skewed the pattern of investment towards the social sectors. To some extent, that skewing was happening before but it got well and truly consolidated by the millennium development goals. The realisation now is that we probably went a bit too far and need to restore the balance.

Q101 Lord Smith of Clifton: You stress in your evidence the importance of domestic resource mobilisation in countries that move away from aid. We have already heard about what Botswana and South Korea represent, but those two countries are rather chalk and cheese, are they not? In Botswana, presumably outside speculators stumbled across the diamonds—and that had nothing to do with internal resource mobilisation; it was just serendipity—whereas in South Korea there must have been a determined policy focus on selective sectoral industrialisation. Can we draw anything regarding domestic mobilisation from those two examples?

Jonathan Glennie: My answer on everything is that you can draw things but it is difficult to generalise them. What worked in South Korea may not work not elsewhere, and what worked in Botswana may not work elsewhere. You are right that most of Botswana's money came from extracted resources. Botswana has not been a victim of what so many other countries in Africa and elsewhere have been a victim of, which is the famous resource curse. In my view, it is not just aid dependency that matters; resource dependency matters as well, and a particular resource that skews the economy. If a country depends too much on one particular resource, generally extracted from the ground and exported, that does not necessarily lead to serious poverty reduction, although it may well lead to growth. I should like to emphasise that point. We have talked a lot about growth, but Nigeria, for instance, is growing very fast, as are a range of other countries. Mozambique is also growing very fast, but there is a phenomenon that is recognised by all the serious economists who are looking at Africa at the moment—it is called jobless growth, and we all know about it. You can have growth without job creation.

Q102 Baroness Kingsmill: And continuing poverty reduction?

Jonathan Glennie: Just look at Nigeria, which is the biggest country in Africa.

Edward Hedger: A piece of analysis was done in about 1961 or 1962. It was an economic survey of Liberia entitled *Growth without Development*. The same pattern is repeating itself where access to particular natural resource inequalities is—

Q103 Baroness Kingsmill: That is the point that I was making right at the beginning about the relief of poverty and economic growth.

Jonathan Glennie: I would just add to Lord Shipley's question. In Britain at the moment there is a political debate about what is going to stimulate growth. It is quite a severe debate and the reality is that the answer is not obvious. Different people think different things based on more or less the same evidence and assumptions. The fact that it is not easy to relate aid to growth is not at all surprising. We do not really know what drives growth. As Lord Lawson said, we know what drives growth in hindsight—that is what economists do—but we do not know what drives growth in foresight. That is really annoying but probably true.

Domestic resource mobilisation is a little bit like that. Domestic resource mobilisation is enhanced when there is growth and then dependency on external funds reduces. We do not really know what drives growth, although we have ideas about it. So what can countries do to improve their mobilisation of domestic resources, regardless of how well they are doing economically? I think that there are answers to that, and one of them is just to focus on doing that. We are producing a piece of evidence for the Bill & Melinda Gates Foundation looking at all the different ways that countries have emphasised the mobilisation of taxes and non-tax resources over the past 20 years. Some have been incredibly successful; some of them less so. A couple of weeks ago the ODI was visited by Allen Kagina, the director of the Uganda Revenue Authority, who is carrying out a range of reforms that are leading to increased tax take. That is of course dependent on growth to a certain extent, although, again, you can have growth without a significant improvement in your revenue collection. Therefore, there are the two elements. I will not go through the list now, as I have not got it in my head, but there are a range of things that have been done by countries that have done well and they are worth sharing. This document will eventually be public.

Edward Hedger: Another reason why some of the evidence that we are looking at shows that it is absolutely imperative that we focus on domestic resource mobilisation relates to the risks or harm that we do. One such risk or harm is encouraging certain patterns of public expenditure over a whole range of sectors. International targets set for key sectors that developing country Governments are encouraged to sign up to are: 4.5% of GDP on social protection; 15% of government expenditure on health; 20% of government expenditure on education; 1.5% of GDP on water and sanitation; and 9.6% of GDP on infrastructure. There are a couple more, including 10% of government expenditure on agriculture. If you add them up and look at the expenditure composition and expenditure patterns, the total is higher than those countries could achieve at the moment and higher than a huge bonus of aid could achieve, yet we are encouraging countries to deliver on them—indeed, we are setting the targets. Without a strategy for domestic resource mobilisation to make this sustainable, we will not deal with the aid dependency question at all.

Q104 Lord Forsyth of Drumlean: Whose targets are these?

Edward Hedger: They are a range of international community targets. There is a paper that I can share with you.

Q105 The Chairman: I am very interested in the document that you have just referred to. When are you producing it?

Jonathan Glennie: I have got to send it off tomorrow, although it will not be published until maybe July or August.

The Chairman: We are in July.

Jonathan Glennie: The end of July or August.

The Chairman: It would be helpful if you could let us have it when you have done it.

Jonathan Glennie: I can negotiate that with Bill.

Q106 Lord Lipsey: Given some of the difficulties with Government-to-Government aid—corruption and getting Governments out of the nasty task of raising taxes to pay for their spending plans in developing countries—it is sometimes suggested that a completely radical alternative might be found, giving the money directly to individual citizens in developing countries either as a group of citizens or as individuals, possibly down their mobile phone. Is there anything in these kinds of ideas? Do they have any attraction? Are they practical?

Dr Alison Evans: I am going to let Jonathan lead on the substance of that question. I shall just say that there are now quite a few mechanisms for citizen-to-citizen aid. You may have captured the phenomena of Kiva, global giving and all the entities that have sprung up in the past two or three years that are providing mechanisms for Governments and citizens to give aid directly to businesses and citizens in developing countries. My only point to start this off is that I would slightly challenge the notion that corruption exists only in Government-to-

Government aid. We have a fair amount of evidence to suggest that that is not the case, and it should not be allowed to continue as a view without a certain amount of challenge. Do you want to take over on the specifics, Jonathan?

Jonathan Glennie: Not quite on the specifics but I have some thoughts on this that you may want to consider. I think that broadly DfID should consider all innovative financing schemes. All forms of financing have their pros and cons. Some are going to work well in some areas but not in others. On the issue of mobile phones, which links in a little with the role of the private sector, it is now becoming fairly well known in the development sector that in countries such as Kenya, the Philippines, India and quite a lot of other places the rollout of mobile phones has transformed many development opportunities, including—this was mentioned in the question—access to financial services. In Kenya, the change over the past few years has been absolutely phenomenal. As I understand it, it was linked to a DfID loan to begin with, working with Vodafone and other private sector companies. That is one of the best examples showing that aid supporting the private sector can lead to what looks like quite a phenomenal change.

As I said before, the aim of development is to build up the state, rather than just to respond to urgent need. However, there may be a tension in this case. I think that the whole cash transfer thing has forced development agencies to ask the question which I think they should be forced to ask: why should aid be put through a bureaucracy rather than be handed straight to a recipient? That is a good question to ask and the development agencies have to be able to answer it. They probably can answer it quite often, although maybe in some cases they cannot.

My only other point is that politics are complicated. The question says that this would force Governments to engage in credible and effective taxation to fund their own public expenditure. I am not sure how that would happen, and I can also see that it would disincentivise Governments. If aid went directly from donor to recipient country individual, I can see how that would disincentivise Governments to make those kinds of welfare payments. Welfare payments in cash clearly led to massively reduced inequality in our country and other countries, so in broad terms they are a good thing, but I am not clear that foreign Governments should be carrying that out.

Edward Hedger: Just to add to that, I am not sure what scale you had in mind. To build on Jonathan's point, clearly it would create large collective action challenges around some of the public goods issues which those individuals would not be incentivised to provide if they were the recipients, so it may be on a smaller, micro scale.

The other question is whether the aid goes to individuals from official aid agencies in the donor country or whether it is more a question of the micro philanthropy that we were talking about—the individualised area. One of the challenges there is, whether you call it corruption or whether you call it risk of non-developmental return, that micro philanthropy is susceptible to all the difficulties of monitoring—of knowing where the amounts are received. One of the purposes of, and reasons for, the emergence of aid bureaucracies is exactly to deal with that problem of asymmetric information, but I do not think that this alone would necessarily deal with that.

A final point that I want to put on the table again concerns the question of developmental return. I was interested in the use of the word "return" correspondent with investment. In the UK at the moment there is a lot of focus on 100 pence of value for every pound of aid spent. That does not take us in the direction of looking at the risk profile of an investment to achieve a higher development return. It risks taking us down to only risk-proof investments with a minimal level of development return, perhaps losing the opportunity to secure a higher development return. These are clearly very difficult political questions to deal with. Nevertheless, they are important ones to put on the table.

Q107 Lord Forsyth of Drumlean: I am fascinated by the question—you say it is a very good question, but you have not really answered it—of why we should need a bureaucracy to deal with development aid. Putting it quite crudely, personally I do quite a bit with India but I would not dream of doing anything through the Indian Government. I know that there is a difference between humanitarian aid and development aid, but the suspicion is that quite a lot of aid will not get to the end source because of the nature of these bureaucracies. Is not the root of the problem that the bureaucracies themselves are, to put it politely, somewhat porous? That is why people look for alternative means of delivering aid and why they look for an effective means of looking at how the money has been spent and what it has delivered. Is that not the central question which we have been tiptoeing around this afternoon?

Edward Hedger: I would also say that what does not strengthen them is the avoidance of those systems. Shining a rather forensic light on those bureaucracies and trying to understand specifically where the weaknesses are is another flipside. Rather than ask where one might use parts of country systems and bureaucracy, one might ask where we cannot afford to take that risk because there is something porous or weak. Elements of those systems may be sufficiently robust, and there may be public monitoring and domestic accountability mechanisms in the country which give us enough proof and confidence that those parts of the systems are sufficiently robust. Looking at wholesale systems from top of funding in to service delivery out includes, particularly in the complexity of a country such as India, a lot of details.

Jonathan Glennie: Losing money to corruption is clearly going to be a massive issue for politicians. I did some work on this a couple of years ago and I could find only one example where giving aid actually led to corruption. Losing aid money is one thing, but sometimes it is implied that we give aid and it supports corruption—in Kenya, for example, where there is a lot of corruption. Are we supporting corruption when we give aid? There is no evidence of that. There was one piece of evidence from Mozambique which, according to the paper that I read—the Hanlon report, if anyone wants to read it—showed that our desire as donors to privatise everything led to the corrupting of the civil service, which was pressured into engaging with dodgy deals. However, in general there is no sense that giving aid leads to more corruption.

Putting aid through institutions means engaging with incredibly complicated institutions. I would agree with Ed. I do not disagree at all with those who try to make sure that their money gets straight to the people whom they want to help. In the long term, the only sustainable support for people living in poverty without much power is better institutions. The question that I would ask is whether aid is supporting the improvement of those institutions. In the case of India, which you cite, it is quite plausible that it is, even though some of it gets lost. I do not know India very well. There is an important distinction to be made between the possibility of money getting lost, as it does in all bureaucracies, and the question of whether aid makes things worse or better.

The Chairman: We have a time limit and we still have quite a lot to cover, so I should be grateful if we could keep the answers reasonably short so that we can get through the agenda.

Q108 Lord Shipley: That takes us to a question about general budget support and the work that you have done on this as a key form of aid. Other witnesses have told us that this is the only way that genuine ownership and effective resource allocation can be secured. Does your research support that conclusion?

Edward Hedger: This question is whether that is the only way of ensuring it. “Only” is a very strong word. It suggests that there is no possibility of other modalities. Our evidence suggests that it is a superior or better way. Let me quickly recap on the three reasons why it is supportive of genuine ownership. The first is the fact that it permits countries to allocate aid and aid resources against their domestic policy priorities, which can be discussed with international donors. The second is the fact that it uses country systems, thereby providing the opportunity to strengthen those systems. It also provides a sense of ownership of the allocation and management of aid resources. It treats them like domestic revenue resources. Thirdly, it provides the possibility of strengthening domestic accountability because service users and domestic constituencies involve answerability and accountability. That logic is, in our evidence, supported by the evaluated findings on general budget support.

In terms of the changes in resource allocation, there have certainly been dramatic shifts in the composition of expenditure in countries in receipt of large amounts of budget support. In parenthesis here, I suggest that general budget support should be expanded to a broader category of budget support, inclusive of sets of budget support. There is a spectrum of instruments for giving aid, not only one or two different ways. The difference between them is that one is not earmarked to particular expenditures, its allocation being at the discretion of government across all its policy priorities; the other has some specific earmarking—perhaps for the health sector, the education sector or the agriculture sector—but it still uses government systems and within that sector involves government discretion about what part of policy priorities it is allocated to.

All this presumes that there is an adequate policy framework—a national development strategy—which is pro-growth, pro-poor and progressive regarding support. That is the case in countries that we have looked at regarding changes in the allocation of expenditure, the strength of country systems and the strength of financial management and budgeting.

Q109 Lord Hollick: In paragraph 19 of your written evidence, you say that there has been “a return to the language of conditionality in UK aid”. You then add, “More evidence is needed to establish current practice in the UK.” Do we infer from this that a change is taking place without a full debate? Why is the change taking place? Were we heading in the wrong direction and being a bit naive up to 2005?

Edward Hedger: Perhaps I may start with a couple of brief comments. First, nuancing on that, some of the very aggressive economic policy conditionalities have been discontinued. Nevertheless, results have always been specified and continue to be specified in terms of the expected developmental return associated with aid. What may have changed over the past couple of years or so is necessarily more explicit focus on, explanation of and articulation of what the results need to be, given the domestic political circumstances in many donor countries. So maybe the profiling and how explicit countries are about the results has changed, as well as there being different sorts of conditions. Conditions are still present but there are different types.

Dr Alison Evans: Very briefly, I am not entirely sure that we have a very clear position on conditionality from DfID at the moment, but that is something that needs to be established. DfID put out a statement in a policy paper in 2005 on trying to move conditionality away from something that was understood, certainly in the 1980s and 1990s, to something that looked much more like a partnership. However, that seems to have disappeared and we are not quite sure what its status is. We are not really sure what the current position is, to tell you the truth, and I think that it needs some work.

The Chairman: It is a question that we can put to the DfID officials who will be coming in front of us shortly.

Q110 Lord Forsyth of Drumlean: We have seen some evidence of the ill effects of aid volatility. Perhaps you could comment on how you deal with this problem—on the one hand creating dependency with a view to maintaining it for the long run and, on the other hand, creating a big problem for a Government which may not be best advised to continue with a programme, given its other public expenditure commitments.

Edward Hedger: Evidence has shown quite clearly that aid receipts have been more volatile than domestic revenue receipts. There are various calculations. The most recent work that we have done shows that between 1975 and 1997 for African countries aid was between 3 and 5.5 times more volatile than domestic revenue. Other analyses suggest that it could be anywhere between 6% and 40% more volatile, so clearly there is a big difference.

To be honest, what we focused on more, which is also very relevant, was the question of predictability of aid—how reliable the commitments have proved to be in terms of the disbursements and receipts remitted to government. There is a clear relationship between the two and the prediction is that a high level of volatility will be mirrored by predictability.

I will say a couple of words on predictability because I think that the two are highly related and we have some firm evidence to show that. First, in high-aid recipient African countries, particularly Tanzania, Uganda and Ghana, we found that the biggest effect at a sector level was the disincentive around development spending. High levels of aid unpredictability resulted in a reduction in public investment and development expenditures, with other sorts of statutory expenditures and consumption expenditures retained. That related to funding overall and within the health sector. The second significant and problematic effect was around the complications of macroeconomic management.

I want to make a couple of points about some of the strategies that were applied to deal with that. Uganda was particularly insightful with regard to how it dealt with the reality of highly unpredictable aid. First, it created high cushions of foreign exchange to be deployed when required. Secondly, there was significant discounting of the aid pledges and aid commitments in the Ministry of Finance forecasting. Thirdly, it held back on certain developmental and public investment expenditure, with the fear of it not materialising mid-way through projects. Those are all significant factors that risk undermining the developmental return expected and planned from aid. Governments deploy strategies to avoid the worst effects of not being able to sustain the patterns of expenditure associated with forecast and planned aid.

The other part of the question concerned the opportunity to deal with this through other direct sources of funding. We have touched on this a little before but there is some valuable evidence, particularly in the health sector in Uganda, of vertical funds providing a large amount of support. Again, unpredictability had significant consequences there. The Government placed undue reliance on receipts for those funds and thus reallocated its own resources through the budget to other supplies. It found that the funds were not disbursed and it was then very badly caught out by a lack of access to some of the most fundamental medical supplies and health provisions. This shows that unpredictability can be just as, if not more, problematic when Government not only manages resources but is not aware of the planning and proper forecasting of those resources. Does that help?

Q111 Lord Forsyth of Drumlean: No. Can you answer the point about volatility? You have dealt with unpredictability.

Edward Hedger: My colleagues have worked on volatility. I have worked on predictability but I would be happy to share a paper with you on that question. However, I think that the two are highly related because the presence of one affects the other.

Q112 Lord Forsyth of Drumlean: I see the point about predictability. If I promise to give you some money and it does not turn up and you have committed yourself to spending it, I can see that that will be a problem. However, if I promise you some money and it does turn up, and you then have a load of people who are dependent on a programme but the money is only for a finite period of time, you will have a problem when the programme ends because a whole load of people who may have become dependent on it will be expecting it to continue. My question was how you deal with that issue.

Dr Alison Evans: There are two elements to that. One is that the worst excesses of volatility within aid flows relate less to time-bound programmes coming to an end and the question of what you do then and much more to stop-and-go decisions about whether aid should be disbursed. That is one of the major reasons for volatility. Commitments are made up front; something happens on the political side and the aid is withdrawn. That is one of the major reasons why flows can be volatile, particularly, for example, within a budget year within a country.

The other point that you make is about dependency. One reason why I think all three of us would agree that it is very important for aid to be delivered through government systems so that they can plan and budget around them is precisely to avoid the problem of not accounting for what to do when a programme funded by aid comes to an end. When a lot of aid goes outside government systems, the problem is that Governments do not even know that it is there half the time. When I worked in Tanzania in the early 2000s, 60% of aid delivered was outside the government budget. Very often the Government did not know when it was coming, what it was being used for and over what time period it was going to be disbursed. It is impossible for a Government to know how to plan its basic services if essentially a lot of that aid is beyond its reach. That situation has been turned around quite substantially of late, so that, although the Government is not controlling it all, it knows that it is there. It is able to plan for it and around it and to make its own expenditure decisions in the light of knowing what is coming into the country, and that makes a huge amount of difference. One way of dealing with volatility is through information and transparency, particularly with regard to aid data. One way of dealing with the dependency problem is by having medium-term expenditure frameworks and forward plans that allow you to plan around coming off dependence on aid.

Q113 The Chairman: In that context in Tanzania, you are talking about basic services, infrastructure and all the long-term planning by Government.

Dr Alison Evans: Absolutely. A huge amount of aid delivered by bilateral donors and international NGOs for the funding of basic health and education services was not being declared to Government through its own planning and budgeting processes.

Q114 Lord Moonie: You state in paragraph 21, "Heavy reliance on the standard allocation model can prevent exploration of the potential for new aid allocation decisions".

Can you enlarge on that a bit and tell us what concerns you about the standard allocation model? Can you suggest available alternatives and explain their relative benefits?

Dr Alison Evans: I will let Jonathan speak on that more directly but we should be clear that that point was not made specifically in relation to DfID. We should have said that this was about allocation models used across the system.

Jonathan Glennie: Sometimes the use of mathematics tends to obscure the need for a professional judgment about the right allocation of aid. Personally, I think that the criteria for most standard allocation models, which involve a combination of an assessment of need and an assessment of either effectiveness or efficiency, are good. The DfID analysis made an assessment of strategic fit with government priorities. Then you get some numbers from it. However, in general I do not think that that should—and actually it does not—replace the need for a professional judgment on what is required.

Secondly, at the beginning of the last decade there were 61 low-income countries. Twenty-eight have graduated to middle-income status within the past 10 years. There was a time when, it being agreed that aid was about poverty reduction, one of the easiest ways to show that a country was allocating its aid correctly to reduce poverty was to demonstrate that it was allocating its aid to the low-income countries. That has to be looked at now. Yes, of course money continues to be needed most in the poorest countries, but the majority of the world's poor people—you may have seen the statistics, which show that 75% of people who live on less than 1 dollar 25 cents a day are in middle-income countries.

So the previously easy pro-poor allocation of money—it was pro-poor because it went to the poorest countries—needs to be looked at again. I am definitely not suggesting that the poorest countries should be jeopardised by this but we have to recognise that the vast majority of the poorest people live in middle-income countries, so what happens about that? I have just written another paper about that, which you can have eventually. It is something that we are thinking about but I do not think that the answers are at all easy to come by. The whole discussion about aid to India is one that you will have come across.

Lord Moonie: That presumably is the argument for continuing aid to India.

Jonathan Glennie: Exactly.

Q115 Lord Lawson of Blaby: A lot of interesting points have emerged from your excellent evidence, which we do not have time to go into, but I should just like to focus on one section of it. In paragraph 25, you say, "An ODA target of 0.7% GNI for OECD donors has excellent political value in garnering necessary aid volumes." It certainly has political value in boosting aid—at least, in this country, where it is impossible to conceive of the extraordinary decision of the present Government to increase aid volumes hand over fist while every other department is being forced to cut back on its spending. This would not have happened without the 0.7% target—I see that. Whether other countries are doing the same, I rather doubt. My question is: what on earth do you mean by "necessary aid volumes"?

Dr Alison Evans: That is a good thing to pick us up on. I had not noticed that we had used the word "necessary" there.

Jonathan Glennie: This comes down to personal views. In my view, all countries should avoid the trap of aid dependence. The idea that a certain amount of aid is necessary in bilateral terms is not something that I subscribe to, but the reality is that we are one of the richest countries in the world. Although we are going through a period of serious financial trouble—something that I would in no circumstances question—it is still not right to compare the levels of difficulty in this country with the levels of difficulty—

Q116 Lord Lawson of Blaby: But that is not the point. Of course these countries have all sorts of problems which are more acute than the problems that we have, but I am asking you what you mean by "necessary".

Jonathan Glennie: Far more than 0.7%.

Q117 Lord Lawson of Blaby: It is a case of the more the merrier, is it?

Jonathan Glennie: Of course, in terms of what development finance these countries need. They need far more than 0.7% of a rich country's GDP. If all of India's wealth was distributed—

Lord Lawson of Blaby: That does not come from aid. They generate their own.

Jonathan Glennie: In my view, we have to provide aid to support global public goods. I do not think that aid is the most important thing. We have to engage in policies that support growth in other countries. That is why I think that DfID should be about—

Q118 Lord Lawson of Blaby: Like, for example, open markets for their goods?

Jonathan Glennie: Absolutely.

Edward Hedger: The programme on which Jonathan and I both work—aid and public expenditure—focuses much more on the quality of aid than the quantity of aid. With the rider that the quality of aid and the developmental return on aid can be assured, the development need that we are seeing will be met.

Dr Alison Evans: You are right to pick us up on that and we should absolutely put a question mark over the term "necessary" in that sentence. However, I should like to draw your attention to what we say further down. Despite the really important symbolic value of the figure of 0.7%, Jonathan is absolutely right that, if you were to revisit what might be required to transform the economies of the developing world, the number would be a lot bigger than 0.7% of our GDP, particularly if you take account of climate change and increasing natural resource scarcities, which are beginning to impact on the opportunities for growth in developing countries. As Lord Stern would say, the figure should probably be closer to 1% or 1.2% of GDP. However, if we are serious about tackling growth and prosperity in poor countries in a world of climate change, then the figure should be 0.7%

Lord Lawson of Blaby: If Lord Stern said it, it must be wrong.

Q119 The Chairman: Can I turn to the last paragraph of your evidence, where you talk about fragile states? You say, "Donor countries are prepared to take military risks, but not to take similar risks in rebuilding the government through the use of government systems." Can you expand on that and say precisely what you think the specific risks are in providing that aid in relation to government systems?

Dr Alison Evans: As you are very aware, there is a growing commitment on the part of the international community as a whole and on the part of the UK Government to allocate more development assistance to countries that are regarded as fragile. Some of these are in-conflict, post-conflict or fragile by a broader definition. At the same time, there is seeming unwillingness to accept that, if you are going to do development well in a fragile setting, you also need to have a very good way of assessing and managing risk. That risk-taking seems to be well understood in relation to security issues, but it is much less well articulated and embraced in relation to the development challenge. The reasons why there are risks are fairly obvious. They are to do with very weak institutions emerging out of often very difficult conflict situations where there has been a lack of resourcing, both human and financial. There are strong political risks in doing development in many of these countries, and there has been a lack of catch-up in the rhetoric in acknowledging that. If we are to engage more forcefully in these countries, there needs to be a much more upfront and transparent embracement of risk. You can get rewards but they have to come with an understanding of the risks. Not everything is going to succeed. For providers of development assistance, the question is: what is the tolerance level of risk in supporting development in these countries? We need an open conversation about that.

Q120 The Chairman: But if you have the open conversation, where does it lead you in relation to policy on government rebuilding?

Dr Alison Evans: The conversation that needs to be had politically here concerns the fact that not everything we do in X country is going to succeed. We are going to have some pretty difficult times trying to support public financial management systems in, for example, the Democratic Republic of Congo. This is the long-term challenge. We are going to commit resources now; we may not see the results for 10 years and there are going to be some left turns along the way, but we are committed to this and are prepared to take that risk. That is the kind of conversation. Equally, there is a conversation to be had with recipients, be they communities, non-governmental organisations or Governments, on how to manage those risks actively, whether they are risks of political interference or simply the risks of having insufficient capacity to deliver.

The Chairman: I am sorry that we do not have time to pursue this further, but we must move on to the last question, which is from Lord Tugendhat.

Q121 Lord Tugendhat: Again, I refer to your evidence. In paragraph 24 you state, "Some analysts argue that the social sector allocation bias resulting from the MDGs requires rethinking at this juncture." Can you expand on that point? By that, I mean: is there a bias towards the social sector in overall spending in aid-receiving countries or in aid spending specifically? Which one?

Edward Hedger: I shall start. One thing to flag up is that in aid-recipient countries, with the volumes of aid from China, India and others, the situation may not be as imbalanced as it appears, with a large amount of infrastructure spending. Some of our analysis has suggested that in the middle part of the previous decade some of the OECD DAC member bilateral aid agencies focused much more on social sector spending than on some of the other targets. One thing we have observed is that, as the agenda around greater recipient country engagement in policy priorities and ownership has emerged, so these agencies have articulated more strongly a rebalancing of some of the infrastructure investment and productive sector investment. That has found its way into country strategy development documents, which have said, "Yes, we need this investment in health and education, but equally our roads are crumbling, our infrastructure is failing and our productive sectors are not receiving support." One of the great benefits of the greater alignment of country policies to complement country systems has been a much greater responsiveness, listening to those agendas, and thus, as the evidence suggests, a rebalancing towards a much more balanced picture across both sectors.

Dr Alison Evans: Many countries in receipt of aid underinvested in those social sectors in the 1980s. Let us be clear that the rebalancing has been on a number of fronts. One has been to bring up to reasonable levels of good practice the amount that Governments spend on basic services in these areas, with a rebalancing towards growth sectors as well.

The Chairman: Thank you very much. We have covered a lot of ground. I think you have indicated that you will furnish us with one or two documents. Thank you very much for your evidence and for being with us this afternoon.

Oxfam, Practical Action, Christian Aid and Save the Children—(QQ 206-251)

Transcript to be found under Practical Action

Oxfam— Supplementary written evidence

WHEN SHOULD DONORS STOP GIVING BUDGET SUPPORT?

Oxfam Policy

What happens when human rights violations start happening in a county already receiving budget support?

Oxfam is a rights-based organization and budget support (and all aid modalities) should contribute to ensuring all human rights - social, political, civil and economic rights (or at least do no harm). Failure to uphold human rights or engage in democratic reform can form legitimate grounds for donors to suspend direct budget support as a signal to developing country governments that their activities are not tolerated. In deciding whether to suspend budget support in the face of human rights violations donors must:

- Adopt a case by case approach

- Ensure a coordinated (with other donors), transparent and participatory process (involving local CSOs), which provides an opportunity for the government to reform its behavior against a set of benchmarks, within a limited timeframe, and ensures independent verification of progress made against the benchmarks

- Ensure that all decisions taken are based on the long-term interests of poor people living in the country. This may mean, that there will be cases where a government is violating its citizens civil rights, but where the impact of removing budget support might actually make the situation worse for citizens civil rights in the long-run, and/ or citizens economic and social rights. In these cases, maintaining budget support may be justified.

- Ensure if budget support is to be suspended that it is done in a graduated manner and that the overall amount of aid to the country does not fall. Poor people should not have to pay twice – once for having a poor government and then again by receiving less aid.

- If budget support is to be suspended, donors should seek to re-direct their aid through other aid instruments, like ear-marked sector budget support or using trust funds that enable donor funding of government expenditure at a distance or via NGOs or stand-alone donor run projects.

What if you are giving budget support to an un-corrupt government, and then things suddenly gets much worse?

If corruption gets suddenly worse in a country receiving budget support, donors should:

- *Measure the level and nature of corruption in a country in a robust and transparent way*, involving maximum local input, and set alongside a measurement of progress in delivering on development outcomes.

- If these measures reveal extensive corruption that is undermining development results, *clear indicators for improvement should be agreed* with the government, in consultation with independent civil society and parliament, where such institutions exist.

- *A timeframe for achieving improvements* should be agreed as should the nature of the penalties should the government fail to achieve these indicators. This whole process should be as public as possible.

- At the end of the agreed timeframe, *an independent assessment of the agreed indicators should be made.*

- If they have not been met and progress has not been satisfactory, *agreed punitive actions should be taken*, including the cutting off of some or all budget support to central government.

Examples of Other Ways of Providing Budget Aid In the Case of Human Rights Concerns: Ethiopia and Afghanistan

In 2005, following a contest election and widespread violations of human rights by the Ethiopian government with significant restrictions on political space, donors suspend their GBS to Ethiopia. However, in recognition that this could do more harm than good for poor people in this country, donors sought to work together to replace it with a Protecting Basic Services' programme: a form of decentralised budget support which still provided vital aid to region/district budgets to ensure vital service delivery in essential services was maintained so kids could go continue to go to school. In addition, and, importantly, this new funding had a built-in focus on strengthening local systems of accountability for service delivery.

Other mechanisms that could be looked at if deteriorations do occur are Multi Donor Trust Funds that can support government funding but allow a greater degree of fiduciary control and political distance. The Afghanistan ARTF provides an example of this. The ARTF is administered by the WB and donors contribute to a single bank account through which funding is then disbursed through one of two windows: the Recurrent Cost Window (RCW) and the Investment Window (IW). The former provides funds through the budget to cover the costs of government to ensure functionality and service delivery (like providing midwifes and doctors for poor people and medicines) whilst the latter provides grants for national development programs in the development budget. As such, the RCW is very similar to BS and the IW is comparable to project aid.

Good Example of Donors Handling Corruption: Zambia

Zambia provides a good example of this process being followed and successful results. Zambia underwent a political crisis in May 2009 when a local whistleblower revealed that the Ministry of health had embezzled $2m. Shortly after the Netherlands and Sweden announced to delay their disbursements until the results of a forensic audit were made available,

In early June 2009 the government of Zambia received a letter from budget support donors in which they pointed out that two underlying principles, namely public financial management and good governance, had been breached. The letter indicated that further strengthening was needed so as to prevent the misuse of funds and reduce the adverse implications on the government's poverty reduction agenda. Dialogue was started up to tackle the concern, and from mid June the donors set up a broad roadmap with specific milestones for improvement. In November 2009, when enough progress was made, the funds were committed and the dialogue was officially concluded. The donors generally regarded the dialogue as positive while the actions taken by the government of Zambia were said to have generated satisfactory progress so far, and a new strengthened Performance Assessment Framework was put in place for 2009-2011.

9 January 2011

Professor Alan Penney—Written evidence

To: The Rt. Hon. Andrew Mitchell
Department for International Development

Dear Minister

As you are aware, about eighteen months ago DFID (Kenya) froze funding to the Kenya Education Sector Support Programme (KESSP) in the face of evidence that over a million pounds of UK funding had been stolen from it. The World Bank and Canadian CIDA did similarly in respect of their shares of the much larger total loss. Last week the Kenyan Government repaid to DFID the money lost. DFID chose to change the modality of its support from pooled budget support to one in which UK funding to the education sector is now channelled through NGOs and private financial management companies.

That money has been stolen is not in dispute, nor is the fact that corruption in Kenya remains very deep with revelations appearing almost weekly, the most recent being related to the World Bank *Kazi Kwa Vijani* (Work for Youth Programme).
I wish to ask you the following related questions:

1. On what basis can DFID (Kenya) claim to be reducing poverty, assisting government to build capacity and institutions by opting to fund and manage its education programme using NGOs and private financial management companies?

2. How sustainable is this approach in Kenya? We all know what happens to projects which by-pass government institutions. They contribute to aid fragmentation and complicate donor coordination by recipient governments.

3. What are the transaction costs involved?

4. How can DFID justify its present support to textbook procurement when the Kenya Publishers' Association argues that it is undermining their industry?

5. If the Kenyan government is too corrupt to work with, and current DFID modalities are unsustainable and not cost-effective, why is DFID still engaging in Kenya? After all, Kenya is not an aid dependent country.

These questions also raise issues over whether the policy of channelling funding through NGOs and private financial management companies is in fact sustainable and providing value for money to the UK taxpayer, let alone effectively assisting countries achieve their development goals.

Professor Penney
15th November, 2011

Professor Robert Picciotto, King's College, London—Written evidence

What role has been played by development aid -- and by foreign aid donors -- in the development and implementation of economic policy in recipient countries?

Aid as an idea has been one of the most influential in economic history. At the origins development pioneers promoted the view that government should have a dominant role in economic management using import substitution and heavy public investment as engines of economic transformation. In this context, aid promoted government led industrialization together with infrastructure development and urbanization. Central planning offices, industrial development corporations and elaborate controls over private economic activity proliferated.

The debt crisis of the 1980's ushered in a new intellectual paradigm. Propelled by the neo-classical resurgence in economics the "Washington consensus" triumphed and the central planning tenets of the early development era gave way to market based principles. Following the implosion of the Soviet Union the aid enterprise was conscripted to promote the historic project of global market integration. The industrial democracies used conditional foreign aid to impose common rules of economic management on a global scale.

Success stories are associated with this structural adjustment era (e.g. Bangladesh, Mexico, Bangladesh, etc.) but outcomes varied widely depending on the quality of individual countries' leadership, institutional capacity and social cohesion. The strong states of East Asia resisted conditional aid but adopted many of its tenets by combining market friendly policies with agricultural modernization and human capital creation. Conversely, severe setbacks to social welfare were associated with the measures imposed on the weakest and most fragile region of the world – Sub-Saharan Africa.

A backlash ensued as the human costs of poor countries' debt energized the advocacy machinery of non-governmental organizations. By then western based aid advocacy and humanitarian organizations had become interconnected on a global scale pressured policy makers in the industrial democracies to adopt changes in the policy orientation of the development industry. It came to pass that the international financial institutions that had would take a backseat to an international civil society buttressed by a United Nations' aid establishment that had always emphasized social objectives in development. A historic milestone in the aid business was reached at the turn of the century with the adoption of the Millennium Development Goals.

Has aid contributed to enhanced growth and poverty reduction or hindered it?

It may be useful to unbundle this question. First, what is the development record? Second, how did development assistance contribute to it? The answer to the first question is unambiguous: productivity has risen dramatically over the last decades. Whereas the United Kingdom took almost sixty years (1780-1838) to double output per person, Turkey did it in twenty years (1957-77), Brazil in eighteen years (1961-79), and China and Korea in ten years (1977-87).

Equally average social indicators have recorded major gains. For example, life expectancy rose from 55 years in 1970 to 69 years in 2008; infant mortality rates dropped from 107 per thousand in 1970 to 67 in 2008; world illiteracy halved between 1970 and 2005; during the same period the number of people suffering from chronic malnutrition declined from 35 percent to 17 percent of the population.
Looking ahead the world is on track to meet the Millennium Development Goal target of halving the poverty rate by 2015 from the 46 per cent level of 1990 despite setbacks caused by the 2008-09 economic downturn and the effects of the food and energy crises. However, progress towards other goals has been mixed and in 2015, roughly 920 million people will still be living under the international poverty line of $1.25 a day.
Aid is of course only one of the contributing factors to economic and social development. Botswana, a success story has grown at 5% a year for over 15 years and it is the largest recipient of aid in Africa. Rapid growth in Uganda and Tanzania has also been facilitated by development assistance. It has improved access to clean water, enhanced access to education and protected millions of children from malnutrition and disease. It has also consolidated peace building efforts, e.g. in Mozambique, Liberia and Sierra Leone.

On the other hand, aid has all too often been wasted especially when geared to the achievement of narrow geo-political goals or mere commercial gains. In particular aid was used to prop up corrupt dictators that backed the west in the bitter ideological confrontation with the Soviet Union and more recently the securitization of aid in the wake of the global war on terror has reduced aid effectiveness. In short, aid works but only if it is well managed.

At least two thirds of aid projects have met their relevant objectives efficiently and policy research has established that there is a positive albeit modest relationship between aid and growth. According to Paul Collier aid has added around one percentage point to the annual growth rate of poor countries.

How do you see the role of official DAC aid, including UK aid and other recipient countries over the coming decade?

A frequent myth holds that country policies cannot be changed for the better through conditionality. Of course, conditionality should not be used in a coercive way to impose standard blueprints since it is now well established that reforms must be closely adapted and sequenced to the peculiar circumstances of individual countries. The evidence is overwhelming that one cannot 'buy reform'. Yet, sensible conditionality is at the core of high quality aid. Experience confirms that with patience, professionalism and trust, sensible operational prerequisites agreed through persuasion and country dialogue can do a lot of good and help to nurture broad based ownership of good economic management principles as shown by Bangladesh, Chile, Ghana, Uganda, Turkey, Vietnam, etc.
This said, the relative importance of aid within the broader gamut of policies that impact on development has declined markedly. In fact, non-aid links have become major mechanisms of resource transfer towards the developing world that are dwarfing the 'money' impact of aid and creating new connections between rich and poor countries (as well as among poor countries):

- Developing countries' exports (about $4 trillion) are more than 40 times the level of official aid flows.
- Remittances from migrants ($282 b) are three times as large as aid flows.

- Private capital inflows ($961 billion) are more than ten times as large as aid flows.
- The reverse flow from intellectual property royalties is broadly comparable to aid flows.
- The damage to poor countries caused by rich countries' environmental practices is huge.

This means that beyond aid, it is the aggregate of rich countries' policies (rather than aid alone) that is most relevant. In the coming decade aid will have to focus increasingly on leveraging its impact through these other transmission belts of globalization. To assess the United Kingdom's contribution to development from this perspective one should take account of the development impact not only of its aid but also its other policies (trade, investment, migration, environment, security and technology) [371]?
A comparative assessment put together by the Centre for Global Development in Washington is available. The UK ranks near the top of the aid, investment and environment components. In quantity terms the UK is now third in line – just behind France (US$13.523 billion) and well behind the United States (US$29.85 billion). As a share of the gross national income, British ODA stands at 0.56%. This is well above than the current average of 0.32% and it compares to 0.21% for the United States[372] but it is still far below the levels of aid provided by Norway, Luxembourg, Sweden, Denmark that have long exceeded 0.7% of GNI, the goal universally endorsed at the 1970 United Nations General Assembly for achievement by the mid-70's.

In terms of aid quality, a useful comparative study has been carried out by the Centre for Global Development. It compares the quality of official development assistance along four dimensions: maximizing efficiency; fostering institutions; reducing burden and transparency and learning. Taking these four criteria together out of 31 donors the UK ranks fourth, behind Denmark, the World Bank and the European Union. Again, this is a very good record. The UK also does well (3rd rank) in private investment and it ranks 2nd regarding environmental policies.

On the other hand, the UK does poorly in the trade, migration, technology and security components of the index. It ranks 13th in trade since it is severely held back by the Common Agricultural Policy that imposes high agricultural tariffs and subsidies (42% protection) on developing countries exports. Perhaps surprisingly the UK also does poorly in terms of its migration policy (18th rank) despite a good record in respecting the international asylum convention: the overall share of the population it accepts from developing countries, especially unskilled immigrants, is relatively low.

Equally the UK lags in the development dimension of its technology policy (18th rank) because of its rigorous intellectual property legislation and the large military share of its R & D expenditures. As for security policy its rating is poor (21st rank) despite its notable peace building contributions and its useful role in protecting sea lanes. These do not weigh as much in the index as the heavy sales of UK military equipment to undemocratic governments.

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371 The CDI has limitations rooted in data constraints (e.g. it does not take explicit account of restrictions on trade in services, anti-dumping actions and preferential trading arrangements; the weights used for the myriad of indicators are arbitrary; etc.) but its methodology is transparent and it brings together comparable data of substantial relevance to the assessment of development policy performance.

372 Private giving by US foundations, charities and citizens is in the range of US$15-25 billion

Do aid programmes strike the right balance between supporting expenditure on MDG-related activities on the one hand and infrastructure investment on the other?

The MDGs are not a guide to inter-sector resource allocations. They are only guideposts of development outcomes. It was always understood that context specific poverty reduction strategies owned by developing countries would be the overarching framework for aid and debt reduction in low income countries. Thus, infrastructure investment is fully compatible with the MDGs. For example investing in water and sewerage systems may be better for public health than injecting funds in a weak and corrupt ministry of health.

This said the MDGs are often misunderstood or misused. The neo-classical resurgence promoted a retreat of the State and induced a severe drop in infrastructure development and agricultural and rural development. In addition infrastructure investment has been severely restrained by donors' sensitivity to fiduciary concerns given the patronage and corruption often associated with infrastructure development and also by social and environmental concerns connected to resettlement, indigenous peoples' rights, deforestation, etc. amplified by an increasingly vocal civil society.

What is the right balance between budget support and other forms of aid, including project aid and technical assistance?

Programmatic aid and budget support are useful aid vehicles in well managed countries prepared to tackle governance reforms and improve public expenditures management. But they are very risky in weak and fragile states and they can be addictive. In countries that do not have acceptable public expenditures management systems in place projects are likely to remain the work horses of the aid business.

Has the Paris Declaration on Aid Effectiveness had a measurable impact on the effectiveness of aid delivery?

The Paris Declaration (2005) lays out norms and principles designed to improve the quality of aid. As such it has been influential. No one can dispute the importance of the five fundamental principles for making aid more effective and tracking progress towards them:

- **Ownership:** *Developing countries set their own strategies for poverty reduction, improve their institutions and tackle corruption.*
- **Alignment:** *Donor countries align behind these objectives and use local systems.*
- **Harmonisation:** *Donor countries coordinate, simplify procedures and share information to avoid duplication.*
- **Results:** *Developing countries and donors shift focus to development results and results get measured.*
- **Mutual accountability:** *Donors and partners are accountable for development results.*

This said the official verdict offered by the PD Evaluation recently launched at the Overseas Development Institute is sobering. Compliance with most PD undertakings has been patchy at best. Alignment and harmonization have improved very unevenly and the results orientation and mutual accountability actions have lagged badly. Most donors have been risk averse and slow to change. Peer pressure and collective action are not yet embedded in the systems including the evaluation itself which does not name and shame as much as it might have for an independent evaluation.

Even more challenging has been the rapid rise in the volume of aid provided by **new actors** (non DAC donors; private foundations; etc.) who have not subscribed to the Paris Declaration. They now originate one fifth of all aid to developing countries.

Aid is often said to generate 'Dutch disease' effects? Are these common?
'Dutch Disease' occurs when fiscal discipline and economic diversification are hindered by an appreciation of the currency caused by excessive rents whether secured from natural resources exports or capital inflows. Huge rents, especially in conjunction with governance weaknesses, lax legal structures are likely to induce corruption and concentration of economic and political power. They can also undermine the social contract between the government and its citizens.

The phenomenon is more commonly experienced by countries highly dependent on commodity exports than by countries highly dependent on aid. In part this is because aid amounts to more than 10 percent of public expenditures in only 30 percent of aid recipient countries. Furthermore there are time tested ways to combat Dutch disease. Capital flows can be restrained; exchange rates can be managed and rents can be captured for building up reserves.

What impact have aid flows had on private sector performance?
In principle excessive aid dependency can substitute for private sector inflows. But aid can also impact positively on private sector productivity through improved infrastructure and communications and by enhancing the enabling environment for productive farming. Aid can also impact directly on the private sector through assistance to private sector companies; by helping to channel credit to Small, Medium and Micro Enterprises and by providing advice and promoting risk sharing through capital market development.

Can development aid, and development agencies, play an effective role in conflict prevention?

Absolutely: policy research and evaluation have identified the major drivers of conflict and these can and should be incorporated in setting aid priorities in fragile states:

- *State failure*: weakened states are conflict prone. They are vulnerable to civil strife; unable to deliver basic social services and cannot guarantee the human rights of their citizens. They also lack the institutions to resolve domestic conflict through peaceful means.
- *Horizontal inequality*: social grievances may escalate into violent conflict due to worsening 'horizontal inequalities' or exclusion of ethnic or religious groups from economic opportunities.
- *The youth bulge*: taking up arms may be perceived as a rational choice by disaffected young men in stagnant economies, especially where a youth bulge (i.e. a high population share within a 15-25 age bracket) prevails.

- *Green wars*: population pressures on scarce land and water resources may exacerbate tensions among groups and lead to civil strife and violence.
- *Natural resource dependence*: competition for access to natural resources (oil, mining, timber, diamonds, etc.) may contribute to conflict while illicit resource extraction provides warlords with resources to purchase arms and recruit combatants.
- *Conflict spill over*: violence is rarely contained within borders given ethnic solidarity, large scale displacement of populations, economically motivated military incursions by neighbours and the growing influence of international criminal and terrorist networks.

Can development aid, and development agencies, play an effective role in post-conflict reconstruction?

Development, the Cinderella of post conflict operations, is often the last to be invited to the ball. Yet economic recovery, youth employment and sound economic management are critical to the rehabilitation of broken societies. Aid operations should therefore be focused on a strategic vision and desired outcomes and milestones that include social and economic recovery and community reintegration.

Policy coherence is critical and all aid donors should march to the same drummer under common leadership (usually the representative of the UN Secretary-General (SRSGs). Close coordination is needed between disarmament, demobilization, and security sector reform on the one hand and economic recovery and integration programs on the other. These should be launched early enough to ensure that peace holds and that former combatants do not resort to renewed violence.

July 2011

Professor Robert Picciotto and Professor Benno Ndulu—Oral evidence (QQ31-50)

Please see under Professor Benno Ndulu

Professor Robert Picciotto[373], King's College, London—Supplementary written evidence

Memorandum on the Evaluation of UK Aid

This note addresses the evaluation policy implications of the newly created Independent Commission for Aid Impact (ICAI) formally launched on May 12th 2011. It responds to the Select Committee Chair's specific request for written evidence about the evaluation dimension of UK development assistance.

Background

The first report of the Independent Advisory Committee on Development Impact (IACDI) [374] stressed the lack of evaluation independence at DFID. It noted the absence of a formal evaluation mandate; the limited oversight exercised over the quality of self-evaluations; the distant reporting relationship to the Secretary of State; and the relatively low grade and status of the Evaluation Department head. Since then evaluation work at DFID has improved but the creation of ICAI has created new challenges as well as unique opportunities for the evaluation of UK Aid.

The advent of ICAI

In his June 3rd 2010 speech at the Royal Society the Rt Hon Andrew Mitchell MP unveiled fresh policy directions for UK Aid. He announced *inter alia* that the value for money of UK Aid programs would be assessed by an "external aid watchdog" reporting to Parliament[375] -- the Independent Commission for Aid Impact (ICAI). This strategic decision set the issue of evaluation independence to rest and it triggered a reconsideration of the Evaluation Department's role within DFID.

ICAI was formally launched on May 12th 2011 under the aegis of the International Development Select Committee. During the launch meeting Graham Ward, ICAI Chief Commissioner, announced his intention to publish an annual report and confirmed that follow up measures taken by DFID in response to ICAI reports would be tracked to ensure that lessons drawn from evaluation findings are acted upon.

The Secretary of State expressed his full support for a strong and independent ICAI and he underlined his determination to emphasize organizational learning and to overcome undue defensiveness within DFID. This forthright stance was fully consistent with the overarching message of the IACDI Chair's last public letter to the Secretary of State[376].

The core challenge facing ICAI

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[373] Robert Picciotto, a former Vice President of Corporate Planning and Budgeting, served as Director-General of the World Bank's Independent Evaluation Group (IEG) from 1992 to 2002. He was a member of the erstwhile Independent Advisory Committee on Development Impact (IACDI) set up by DFID in 2007.

[374] The Independent Advisory Committee on Development Impact (IACDI) reported to the Secretary for International Development. Having been superseded by ICAI it held its last meeting on October 11th 2010. http://www.parliament.the-stationery-office.co.uk/pa/cm200809/cmselect/cmintdev/220/220we18.htm

[375] ICAI reports to the House of Commons International Development Committee.

[376] http://webarchive.nationalarchives.gov.uk/20101216162913/http:/iacdi.independent.gov.uk/

ICAI has been tasked with fulfilling a solemn commitment: the regular provision to British taxpayers of independently validated information as to exactly how overseas aid money is being spent; whether it is being spent on key priority issues and whether UK Aid is delivering results. Such a commitment implies that comprehensive evaluation information regarding DFID's spending and its impact should be published on regular basis so that citizens and their representatives would have access to clear, regular and credible information about the effectiveness of UK aid.

The Chief Commissioner has acknowledged the complexity of this broad remit. In his June 27th transmittal letter of ICAI's initial report to the International Development Committee, he stated that he and his fellow Commissioners did not underestimate the challenge they face. Specifically, he recognized that ICAI will have to rely on a good internal monitoring and evaluation effort within DFID and he indicated that joint evaluations with experienced development evaluation units would figure in the ICAI work program.

Independence does not mean isolation

All an independent aid watchdog can reasonably be expected to do is to carry out spot checks and attest to the validity of operational managers' development effectiveness claims. Just as financial auditing requires the prior production of verifiable accounts, independent evaluation of UK Aid will be heavily reliant on DFID's own capacity to carry out reliable self evaluations of UK aid operations. No independent watchdog on its own can be expected to compile comprehensive and valid information about the results of such a large, diverse and growing aid program as DFID's.

It follows that independent evaluation by ICAI should be combined with effective internal evaluation systems within DFID and that principled cooperation should be nurtured between the internal and external evaluation functions. In turn this calls for common evaluation concepts, effective quality oversight and regular professional interchanges between the internal and external evaluation functions. Given the Secretary of State's call for evaluation rigour it also calls for greater resort to independent and rigorous impact assessments.

Absent a coherent interface between the two functions, including a shared understanding of value for money concepts; coordinated evaluation programs as well as explicit protocols of professional interaction, incoherence and duplication may result.

DFID needs a strong evaluation system of its own

Both accountability and organizational learning require a strong and responsive evaluation system within DFID. IACDI's review of evaluation report quality[377] led by Roger Riddell pointed to a mixed evaluation quality record. As a result, the central Evaluation Department under the leadership of Nick York made major strides in strengthening its quality assurance processes and enhancing the competencies of its staff.

However, the Evaluation Department's direct role in ensuring high quality evaluation work has been superseded by the new ICAI structure. The now smaller evaluation department within DFID[378] led by a Deputy Director will only play a supporting role towards embedding of evaluation into DFID's programmes, providing technical advice and training to operational staff charged with commissioning decentralized evaluations within policy and operational

[377] http://www.publications.parliament.uk/pa/cm200910/cmselect/cmintdev/48/48we25.htm

[378] The budget of the Evaluation Department has been cut by about 30% and the evaluation team has been reduced from 22 to 16 staff

teams and developing the network of evaluation specialists (currently 25) who constitute these teams.

This is proving to be a skills intensive and demanding endeavour. Building evaluation capacity throughout the DFID organization and helping operational managers to incorporate evaluation within their programs as well as at all stages of the project cycle calls for collection of baseline data and objective assessments of the evidence for what works and doesn't work at all stages of design and implementation over the life of individual operations and beyond.

New guidance and templates have recently been issued and DFID is making heavy use of external training courses. The Evaluation Department is also developing a set of DFID training modules from basic to intermediate level. An accreditation system against evaluation competency benchmarks for commissioning and managing evaluations now in place has processed 70 staff.

Within each operational area (i.e. thematic groups and country teams) evaluation programs are currently being developed with advisory support from the Evaluation Department. Evaluation specialists now form part of operational teams and they are charged with contracting evaluators for decentralized evaluations with advice from the Evaluation Department.

While quarterly and annual management reports have included project scores, quality ratings for projects under implementation (as well as development effectiveness ratings for completed operations) have not been critically reviewed or their progress tracked on a systematic basis, e.g. through annual reviews of development effectiveness.
More generally quality assurance of project completion reports has been patchy and independent validation of completion ratings has not been carried out systematically. Being focused on implementation (rather than outcomes and impacts) these basic building blocks of operational learning and accountability have not been perceived as evaluation instruments.

Aid operations have not routinely been designed and managed for results
Given the Secretary of State's results orientation a vast cultural change is underway throughout the organization. Until recently aid operations had lacked clear goals, verifiable objectives and adequately funded monitoring and evaluation arrangements. The log frames prepared by operational staff for new operations had not been regularly checked for their quality or rigour. The quality at entry and supervision quality of DFID operations had not been independently measured and tracked in real time. Little analytical effort had been devoted to projecting likely development impact or verifying results on the ground.

Under its new management DFID recognizes that the main evaluation gap that needs to be filled lies in the limited *"evaluability"* of aid operations. The evaluation and results frameworks/strategies now mandated as part of major country and policy programmes are expected to improve the situation. The enhanced operational plans which were agreed as part of the Bilateral and Multilateral Aid Reviews should also help. In parallel, the Evaluation Department is encouraging the conduct of impact evaluations through advice on design and training. A research study is underway to identify methods for impact evaluation other than experimental methods.

Coherent measures of development results are needed

Value for money concepts, DAC[379] evaluation criteria and Paris Declaration effectiveness measures are distinct but they overlap and they have yet to be incorporated within coherent and user friendly analytical frameworks. DFID is in the process of rectifying this situation under the aegis of its Investment Committee. One of the main connections being strengthened is between efficiency as a DAC criterion and the "value for money" concept promoted by the UK Treasury.

Evaluation data on outputs, outcomes and impact feed into measures of development effectiveness. The greater emphasis on prospective evaluation and stronger quality at entry processes for large programs under the leadership of the Chief Economist are inducing programme managers to carry out proper baseline studies and *ex ante* appraisals. The new business case process requires economic appraisal to be done properly and for "value for money" concepts to be explicitly considered.

Evaluation governance is fragmented

All corporate management groups generate and use information about development results. This puts a premium on teamwork among the Director Generals under the direction of the Permanent Secretary assisted by the Management Board and the Investment Committee.

With respect to aid effectiveness, Richard Calvert, the Director General for Corporate Performance is the hub for such interactions. He oversees the Human Resources, Communications and Business Solution Divisions as well as the Finance and Corporate Performance Division, the Internal Audit Department and (through a dotted line) the Evaluation Department which now reports to the Director Research and Evidence Division under the Director General for Policy and Global Issues.

This new reporting arrangement brings evaluators under the same reporting line as DFID's sector analysts and research staff. But the modest status of the Evaluation Department head within the organization (four levels below the Secretary of State) means that he has limited clout and lacks authority over decentralized evaluations. It remains to be seen whether this highly decentralized structure will achieve a balanced and coherent evaluation program across units.

Management practices and systems should serve results based management

Time will also tell whether the on-going change process will generate a decisive shift in the incentives framework and deliver an effective *results based management (RBM) system*. To ensure that the reform succeeds, a detailed review of project approval, supervision and completion reporting processes should be considered since the usefulness of the data retrieval system about aid operations (ARIES) depends in large part on the scope, timeliness and quality of available data about the "quality at entry" of projects[380]; the quality of supervision and the "quality at exit" tracked by PCRs[381].

At the operational level, unless country programs and projects include verifiable objectives, baseline information and built-in monitoring and evaluation systems they are not readily

[379] DAC is the acronym of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD)

[380] The adequacy of economic analyses, social, environmental and conflict sensitivity assessments should form part of the review.

[381] The EvD's evaluation of DFID's compliance with the Paris declaration (2008) disclosed that the civil society has long expressed frustration about the lack of readily accessible project level information, especially regarding development aspects.

evaluable. Equally critical is the effectiveness of supervision (implementation reviews); the extent to which they lead to timely adjustment of project designs (e.g. through mid-term reviews) and the incentives for achieving results generated by fair, transparent, well crafted completion reports.

ICAI proposes to undertake 10-20 free standing evaluations but it is not currently focused on carrying out systematic assessments of DFID operational processes; on attesting to the adequacy of self evaluation methods; on carrying out independent audits of self evaluation reports or on providing a check on the experimental research and evaluation methods currently underway. Most of all, ICAI does not plan to undertake comprehensive and independent meta-assessments of DFID's development effectiveness. These gaps should be filled as ICAI's work program matures.

Conclusions
There is no getting around the need to (i) enhance the *evaluability* of UK aid operations; (ii) ensure coherence of evaluation concepts and standards within DFID; (iii) strengthen the results orientation of operational management processes and supporting data systems within DFID; and (iv) commission periodic, coherent and independent assessments of the overall quality of UK aid (e.g. through annual reviews of development effectiveness).

DFID senior managers are well aware that the creation of an external evaluation function is not a substitute for effective accountability and learning processes within DFID. But in order to achieve results synergy between the new internal and external evaluation functions will have to be nurtured. Careful institutional design; coordinated evaluation programs and greater ICAI emphasis on process evaluations should be considered to create an effective interface between the two functions.

The Evaluation Policy of DFID is being updated to reflect the new government's priorities, the changes around ICAI and the "embedding" of evaluation in all operational areas. This work is being carried out by a senior committee chaired by Michael Anderson, the Director General for Policy and Global Issues. A review of the new Evaluation Policy document by Select Committees in both Houses of Parliament would help ensure that the issues raised in this note are being tackled in a comprehensive and timely fashion.

14 July 2011

Practical Action, Christian Aid, Save the Children and Oxfam—Oral evidence (QQ 206-251)

Evidence Session No. 7. *Heard in Public.* *Questions 206 - 251*

TUESDAY 13 SEPTEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Baroness Kingsmill
Lord Lawson of Blaby
Lord Lipsey
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Witnesses: **Simon Trace**, Chief Executive, Practical Action, **Alex Cobham**, Chief Policy Adviser, Christian Aid, **Patrick Watt**, Director of Policy and Research, Save the Children, and **Max Lawson**, acting Head of Advocacy, Oxfam.

Q206 The Chairman: Good afternoon, gentlemen, and thank you very much indeed for coming. I am sorry about the slight delay, but we had some business to deal with. We have today three witnesses, representing three UK-based NGOs. I regret that unfortunately Oxfam told us yesterday that they could not appear because their intended witness had other urgent business, but I am sure that our three witnesses will adequately cover the ground. Welcome to the Economic Affairs Committee. This is our seventh public hearing in the inquiry into the economic effect of development aid. Thank you also to Christian Aid and Save the Children for your written evidence, which we much appreciate. I would be grateful if you could speak loud and clear for the webcasts and the shorthand writer. Now, I know that most of our questions could be answered by all of you, but, in the interests of time, if you agree with the first response, do not feel it necessary to add to it, but if you disagree or want to add something please do so. Would any of you like to—

Max Lawson: I am Max Lawson from Oxfam. I am five minutes late, I apologise.

The Chairman: I have just apologised for your absence because we were told you could not appear.

Max Lawson: A surprise entrance—sorry about that.

The Chairman: We are very pleased that you could come. Would anyone like to make an opening statement or can we go straight to questions?

Simon Trace: I think you can go straight to questions.

Q207 The Chairman: Of course all of your organisations are very well known, not only in the aid field, but more generally, but I wonder if you could, just as a starting point, briefly describe your organisation's role within the broader British and international overseas aid effort. In particular, we would be interested in your relationship with DFID.

Patrick Watt: Very briefly, I think what I have to say about Save the Children applies equally to all the other organisations here. We are all raising money from the UK public for our programmes and for our humanitarian work and, at the same time, we are handling money of the UK Government and of other official aid agencies in order to support the same efforts. So we are both a fundraiser of private development aid and a contractor and partner in handling public, official development aid. We also, I think, all have a role to play, which we all recognise as an explicit part of our remit, to educate the UK public about international development issues and about aid, and certainly Save the Children sees that part of its remit is to maintain public support for international development and, as part of that, for the aid effort.

Simon Trace: To add to what Patrick just said, Practical Action is a specialist NGO. We focus on the role that technology can play in fighting poverty and transforming people's lives in the developing world. I would agree with everything that Patrick has just said, but, in addition to that, we see our role in the developing world as not only delivering projects and benefits on the ground for poor people in the countries we work in, but also trying to use that work effectively as a lever for a greater amount of change. So in addition to service delivery, for example, we are interested in trying to change the policies and practices of other institutions and agencies working in those countries, including national Governments and other aid delivery agencies to ensure that the best possible practice is used to fight poverty in the developing world.

Alex Cobham: Just to add to that, Christian Aid is the development agency of 41 sponsoring churches in the UK and Ireland, as well as being part of an international alliance of similar agencies, fulfilling the similar roles to those that Patrick and Simon have talked about. We are happy that we feel we have a very strong relationship with DFID in terms of not only working together in countries where we have programmes, but also working together around the knowledge of development of aid: what works and what does not. We also have a role in holding them to account, which is important, as well as being the recipients of UK aid.

Max Lawson: As Oxfam, we reach out to millions of people across the UK. We share or stand shoulder to shoulder with DFID in making the case for development and continued

British leadership on development; we are all very proud of the leading role the UK plays. Certainly for Oxfam, I have attended many G7 and G8 meetings, and it is very clear that the UK has an incredible role to play as a leader in this area and we are very supportive of that. I would also echo what Alex is saying; we are very much a critical friend, who is always seeking to lobby DFID to improve. We think there are definitely areas where they could improve, but they are doing a great job. We are all very much agreed that we need to work side by side to convince the British public that this is a financial commitment that they should make with their taxes and that it does make an incredible difference to the lives of millions of people.

Q208 The Chairman: We will come on to public attitude in another question, but, again as background, could you say very briefly what proportion of your resources comes from DFID?

Max Lawson: For Oxfam, it is about 10%.

Alex Cobham: For Christian Aid, it is closer to 15%, although that includes money that is from competitive tendering as well as grants.

Simon Trace: For Practical Action it is probably around 10% for the PPA and then a variable amount, amounting to perhaps another 2% or 3% depending upon the particular contracts we hold in countries at a particular time.

Patrick Watt: It is 15% to 20% for Save the Children, and, again, it fluctuates from year to year because a lot of that is competitive tendering and not just grants.

Q209 Lord Lawson of Blaby: I was interested that Mr Trace said that one of the things his outfit was on about was changing policy or trying to persuade changes in policy. What changes would you like to see?

Simon Trace: We are interested in this on a number of levels. Maybe examples are the best. In the countries we work in, we are interested in policy changes and practice changes that will obviously directly benefit poor people. In the last couple of years, we have done a lot of work around energy, and particularly household use of energy: we have helped in Nepal to establish national indoor air pollution quality standards for the country, with the Government there; we have worked in Kenya on establishing a feed-in tariff for renewable energy to expand energy provision in rural areas in Kenya; and in Peru, we have worked with the national Government to get manuals on best practice in terms of disaster risk reduction into municipalities across the country. So there is a very practical level of policy and practice—

Q210 Lord Lawson of Blaby: What you are talking about, just for clarification, is changing policy in the recipient countries; you are not talking about any change in policy by the United Kingdom.

Simon Trace: We do both. We work on both. If we stick with the energy example, next year will be the UN's global year on energy access, 2012; we will be working with the UN Foundation, as one of the lead campaigners to raise public awareness on the issue of energy access across Europe. Today we have two or three MEPs in Kenya, visiting households and looking at the problem of energy access in Africa. We are working through those. We are trying to work with the Development Committee of the EU to produce an initiative report for the Parliament on energy access as an issue. We are trying there to raise that particular issue, as something that we think that the EC, the British Government and bilateral donors in general should pay more attention to in the future.

Q211 Lord Tugendhat: Mr Watt, you used the words "DFID and other development agencies". I just wondered if you could tell me who the other development agencies were. Secondly, all of you gave rough figures for the percentage dependence on DFID and I just wondered to what extent that had varied in recent years.

Patrick Watt: In addition to the UK Government, we do get income from the European Commission, from some of the other multilateral agencies in the UN system, and from other bilateral donors, for example, USAID, Irish Aid and others. It is a fairly diverse portfolio of funding from official donors and also increasingly from private trusts and foundations, so, for example, the Bill & Melinda Gates Foundation is a donor to Save the Children. In terms of the trend in DFID support to Save the Children, I cannot give you an accurate answer now, so I do not want to try. However, I think this share of official donor funding in our income has been more or less constant over the last few years. What we have seen is a relative increase in humanitarian funding, from both private and official sources, relative to our development funding.

Q212 The Chairman: And with this point about the other development agencies, would that be true of the other three?

Simon Trace: Yes, it would certainly be true for Practical Action; the mix is roughly the same. In terms of the trends with DFID financing, if you go back three or four years the current level is maybe 15% to 20% higher. If you go back five to 10 years, it is probably about the same or slightly less than it was, so it has fluctuated over time.

Alex Cobham: That is probably quite close to the picture for us, too. We have seen a bit of an increase over the last few years, particularly around competitive contracts, working in the DRC and Sierra Leone on building a civil society to hold government to account, which DFID has been more focused on.

Max Lawson: Yes, we are certainly very conscious of it, in regard to trying to keep a ceiling, in fact, because it is part of our approach that we want to be seen to be independent; particularly in humanitarian and security situations, it is very clear that we are not more than around 10% funded by the UK Government.

Q213 Lord Tugendhat: What role do you see for aid in supporting growth and development in the world's poorest countries? You have already indicated that you think that the British aid programme plays an effective part. Could you explain a little bit about how you think that NGOs can reinforce that?

Max Lawson: There are two answers. I think there is the more traditional growth-enhancing activity. For us, it is largely around agricultural livelihoods, so helping people primarily to grow enough food for themselves, but also to engage wherever possible in supply chains and in the market and to be able to generate their own increase in income. It is crucial to underline the important role of the other side of the coin, which is that we are very, very supportive of investment in universal primary education and in free healthcare; these things are not traditionally seen as growth-enhancing, but they are in fact incredibly important to growth. We think that one of the biggest contributions that British aid has made in recent years has been the drive to get every child to read and write, and to get kids into school. These are the entrepreneurs of tomorrow. They are the small business people. I am talking particularly about the young girls, to ensure that they have the life skills to engage in the productive economy. So this is about traditional private sector development but also investment in public services.

Alex Cobham: Christian Aid's model is a bit different in that we do not work operationally in countries; we support partners that work there. This is something that is difficult for DFID to do directly, but the impact of that can be great. As an example, we have a partner in Ghana that has worked across the country to hold the Government to account for commitments it had made to education but also around providing meals at school to children. In doing that, by engaging the population—not only funding government to deliver something, but, through this partner, engaging civil society more broadly to hold government to account for doing that—the return on that investment that DFID has made through the Ghanaian Government has been much greater than it would have been. I think that is an important additional strand.

Q214 Lord Tugendhat: Could you help me on this point? We are talking about helping poor people in poor countries. The reason we want to help poor people in poor countries is to enable them to become less poor, both the countries and the people, to improve their life chances, to assist economic development and so forth. So, if you have a poor country with lots of poor people in it, then I see a real role for what British aid is trying to do. My problem comes over India, because here you have one of the most successful economies in the world and it is an economy now with a thriving space programme. It has its own aid programme. It is one of the biggest investors in the UK, and so forth. The Christian Aid submission points out, and others have pointed it out too, that there are 70 million very poor people in Madhya Pradesh and that the levels of poverty are the same as in the Democratic Republic of Congo. However, whereas the Democratic Republic of Congo is a very poor place indeed, and does not have the capability, by itself, of improving the lot of its people, India does; it has many of the richest people in the world and it has very successful companies. The fact that there are so many poor people in India is a reflection of the priorities of the Indian Government; it is a sovereign independent Government, so it is perfectly entitled to have its own priorities. It has its priorities and the people in Madhya Pradesh do not appear to be as high as the space programme or the aid programme or anything else. Why should we fill the gap?

Alex Cobham: It is a fair point that Madhya Pradesh is not equivalent to the DRC in the sense of being a sovereign national Government, but the underlying issue is that this is the context in which people are living. If we are to say that anyone who is poor in a country that is poor will be appropriately positioned to receive UK support, but anyone who is poor in a country that is not as poor and in which the Government is not addressing them as a priority, then that is bad luck, I think we draw a line that says, effectively, the UK approach to development will be to leave to chance whether or not particular poor people are suitable recipients of support. Increasingly, we have seen over the last 10 years in particular a lot of low-income countries graduate to middle-income status; the majority of the world's people living on less than a dollar income a day are now in those middle-income countries. It does not feel, to Christian Aid certainly, that this should be a moment to walk away from all of those countries, simply because the average GDP of those countries is above some more or less arbitrary level; rather, we should say that these people continue to be people living in poverty. It may mean that we work differently in those countries, so that perhaps more work that we do in India will be around holding the Government to account to deliver basic rights to people. That is a question of approach, rather than engagement or disengagement.

Patrick Watt: If I can just add to Alex's comments, I think there is a question about whether British aid is there to help poor people or poor countries, given that there is a large and in fact growing proportion of the world's poor living in middle-income countries. Now, how you address poverty reduction in middle-income countries is going to be very different from how you address it in low-income countries, where state capacity is much more limited and resources are much scarcer. You would expect that, as a country becomes wealthier, poverty becomes increasingly about inequality; it becomes about political choices domestically, and aid needs to change and adjust and be used to try to address some of the obstacles to the right political choices being taken. Increasingly, in India, aid is going to need to be used to strengthen the capacity of Indian citizens to claim their rights from the Indian Government at state and federal level. Increasingly, it is going to have to be about building civil society voices that create a climate in which the right political choices are taken. That is a different model from aid being provided as a straight resource transfer, state to state. That transition does need to take place in countries as they develop and you move from a model of aid as a straight resource transfer to aid as a catalyst for political change.

Q215 Lord Forsyth of Drumlean: May I just ask whether Mr Watt thinks DFID subscribes to that view?

Patrick Watt: It would probably be best to ask DFID directly. I think DFID subscribes to that view to some extent. I think DFID is increasingly focusing its aid at the state level, in states where there are particularly high levels of poverty. In India, it is making decisions about where the aid should go. It is increasingly seeing the importance of Indian civil society to poverty reduction in India. I do not think that transition from the model I have described, from a resource transfer model to a catalytic model, has necessarily been completed in the DFID aid programme, but I think that DFID has recognised that that is where it needs to go.

Q216 The Chairman: Can I just ask you about what you described as the "catalytic model"? If I heard you right, it sounds to me like you are talking about aid becoming more supportive of lobbying organisations on Governments rather than direct aid itself.

Patrick Watt: I do not think it is necessarily about lobbying. I think a lot of the work they could be doing could be simply making people aware of their rights from the Government and creating more responsive political environments. At the very local level, it could be as simple as enabling communities to hold local government education offices or clinics to account for whether or not they are delivering a decent service. I do not think it necessarily needs to be about lobbying in the sense of people going in and doing high-level influencing in Delhi or in any other capital city.

Simon Trace: Can I just add to that? Potentially in these situations, it is as much about knowledge transfer as political influence, so transferring lessons about how poverty has been successfully addressed in other places to places where it is not being done at the moment. We are involved at the moment in a DFID-funded programme that is looking to transfer successful lessons from Latin American to sub-Saharan Africa and south Asia, and I think that is one example of that.

The Chairman: That is somewhat different.

Q217 Baroness Kingsmill: I wanted just to declare a potential interest. I am a director of a company that provides temporary energy solutions in developing countries and in emergencies.

I wonder if you could just clarify for me the distinction in your minds between development aid and humanitarian aid. It seems from some of the things that you are saying that there is a considerable overlap. It might help us to understand some of the political implications if you just gave us your views about that distinction.

Alex Cobham: Humanitarian aid is aid that responds to the humanitarian imperative to meet people's immediate needs for adequate food, shelter, water and so on. So, it is meeting their immediate survival needs and, often, meeting those needs in the context of emergencies, such as droughts and tropical storms. It could be emergencies arising from conflict, as well as from natural disasters.

Q218 Baroness Kingsmill: Poverty itself does not come into that list, or does it?

Patrick Watt: It comes into it in that the people most likely to be affected by emergencies and least able to cope with the consequences are poor. Your vulnerability to disaster and your vulnerability to conflict are much higher if you are already poor. There is obviously a continuum between responding to an emergency and doing development work. A lot of the time, we are responding to emergencies in places where we already have a prior presence doing development work; so a lot of our development work is increasingly about disaster risk reduction, so trying to equip people to be more resilient in the face of emergencies and better able to protect their livelihoods and their assets in those situations. Increasingly, we are looking at how to transition out of humanitarian emergencies into longer-term development work. In some places, that is a challenge because the international development community is often quite split, so you will see that the funding streams available through the UN to respond to emergencies are quite different from those that are available for long-term development work. Clearly, the two are very closely connected.

Q219 Lord Smith of Clifton: From your perspective as major British NGOs, how would you assess the overall effectiveness of DFID as an aid agency? Before you answer, can I just say that it has been my experience in this Committee so far that there is a chorus of approval and self-congratulation on the part of DFID and all the witnesses we have had so far that Britain is best at all this sort of thing? Frankly, it is becoming a set script. Are there any areas where you think DFID falls short or could do better? Or because you are recipients of their tenders or grants, would you rather not mention it?

Max Lawson: I am happy to go on the record and criticise DFID. I think working as we do, facing lots of different rich–country Governments, the UK does shape up well, but could it do a lot better? Absolutely, definitely. Other Governments, such as those of Denmark, Sweden and Norway, have been giving more and giving it better for much, much longer than the UK. We are very much a new entrant into the progressive government sphere. I think key areas that Oxfam is interested in are the predictability of our aid as the UK. I think it is incredibly important that Governments in poor countries know that there is going to be consistency of policy; this is one thing that we have been very concerned about with the change of Government in the UK, that we do see some consistency. One of the areas in which DFID has led the world is in support to government budgets and support to Governments to deliver services themselves; we have been really pressing DFID recently to continue to do this and we are very worried that we are seeing that level of support available to Governments directly being eroded. We do not want to see too much chopping and changes in policies largely for reasons of politics rather than reasons of rational assessment of what is working. We are very closely watching DFID at all times, whether it is at country level or here in the UK, to hold them to account for promises that they have made and always to press them for improvement. They are certainly the best Government within the G7 at giving aid, but the rest of the G7 have a very, very poor record, so it is very much a case of comparison rather than there being no room for improvement.

Simon Trace: I agree with everything that has been said so far, but I would just add that one other area of concern in recent years has been that DFID has changed over time and is putting a lot more money now through other multilateral institutions than it did before, so, to an extent, the effectiveness of DFID depends on the effectiveness of those institutions. This just means that the control is one step further removed. We are depending on the effectiveness of the World Bank to deliver aid because a significant chunk of DFID's budget does go through that institution.

Q220 Lord Smith of Clifton: Has there been any significant change since the last general election? You mentioned political pressure and so on; does that trickle through?

Max Lawson: I think there have been, quite rightly, some new priorities with the new Government, some of which are very reasonable. I think the idea to scrutinise DFID independently and have more of a focus on ensuring that there is value of money and that we can demonstrate results with our aid are all very laudable aims, but that has to be done in a way that looks at the continuity with the policies of the past, the fact that these are incredibly difficult environments to operate in and that there are very few quick fixes, and that DFID has taken some very brave decisions over the last decade in terms of supporting difficult policies in difficult environments that are really starting to reap dividends—some of the most fragile states and the most difficult operating environments. It is a mixed picture; there are definitely some real changes happening in DFID, but a real desire to keep the best of what they have done and to improve upon that is what we are pushing for.

Patrick Watt: Perhaps two of the major changes that have taken place since the new Government came in are, first of all, as Max was saying, the focus on value for money and results, which in principle is a good thing; it is a good thing both because people in poverty need aid that generates results and because there is an issue of accountability to the UK taxpayer—the UK taxpayer needs to be assured that aid is being spent well. The risk, of course, is that if you overemphasise results you end up only supporting aid interventions that deliver quick, attributable, visible results, often at the expense of change that could be brought about through longer-term, more difficult, less immediately obvious interventions. I think the other issue is about allocation and the choice as to where British aid goes. Obviously, there was a review, both of multilateral aid and of bilateral aid, so we have seen a shift in bilateral aid towards countries such as Pakistan and Afghanistan, which of course have enormous unmet development needs, but there are some countries—Burundi, would be an example, Niger another—that seem to have lost out as a result of the bilateral aid review. It is not always clear whether what is driving those decisions is poverty reduction or whether political considerations are blurring some of the choices that are being made.

Q221 Lord Shipley: All of you, along with the majority of British NGOs, have endorsed the proposal to build into legislation the requirement that the UK spends 0.7% of GNI. Is that target soundly based and why is it important? What would be gained by a change from policy objective to legal obligation?

Patrick Watt: I am happy to kick off on that. The target was adopted back in 1970 as a result of the Pearson Commission. It is a long-standing target. It was adopted through the UN. It is important to note that this is a target that has been agreed and adopted right across European Member States. It is actually a target that has been achieved by five European countries—you asked whether or not it is achievable, so we know it is. It should be as affordable in a downturn as in an upturn, given that it is a fixed share of national income; so if our economy is shrinking we pay less in aid to achieve 0.7% than we otherwise would. I think on all those counts it is achievable and I think for a country like the UK it should be affordable, but also seen as a wise investment, in terms of contributing towards a stable and prosperous world but also as an important reflection of British values. The British public is broadly supportive of the Government meeting its promises on international development.

The reason for legislation is twofold. First of all, by protecting the aid budget from political jockeying, legislation shifts the terms of debate away from whether or not to reach 0.7% to a discussion about how to spend that money well, which I think is an important transition to make. If you look at Scandinavian countries where there is a consensus around 0.7%, the conversation is about how to use that money really effectively, rather than about whether or not to give it. I think the other reason for legislation is that it will send a very powerful message to other donor countries, as well as to developing countries; it will enhance the UK's ability to play a development diplomacy role internationally and to leverage commitments from other donor countries.

Simon Trace: I have two things to add. One is that its basis, as Patrick said, comes back from discussions around a target of 1% that started in the 1950s. It does not really matter that much what the basis for the original point was; it is a modest target. It is particularly modest in terms of the amounts of money that are expected to be needed, for example, to help poor people adapt to climate change over the coming 50 years or so. It is a modest target which, as Patrick said, is affordable and therefore is a reasonable thing to go for. Legislation, making it a legal obligation, would put it in a position where this consistency of delivery of UK aid would be achieved because it would therefore be much more difficult politically to change the amount. This was something that Matt referred to earlier on.

Q222 Lord Lawson of Blaby: I have noticed, if I may say so, that when people have no argument worth speaking about they always invoke climate change. I have one or two other things. First of all, you said that you want to persuade other countries—that is part of the reason for this. Is there any other country that has the faintest intention of making the 0.7% a legal, mandatory legislative requirement? I am not aware of one, but no doubt you can tell us about many. The second thing is that you say, and I am sure this is right, that there needs to be a shift in emphasis from the quantum of aid to the results of aid, yet this is going in precisely the opposite direction. I am absolutely baffled how you can possibly support this proposal.

Patrick Watt: I think the UK has made a promise and I think the UK ought to keep its promise.

Lord Lawson of Blaby: If I may say so, when I was a Minister in the 1980s, we made a promise, all NATO members, that we would spend 3% of GDP on defence. That was a solemn promise under a treaty; nobody ever suggested it should be made a legislative mandatory requirement and it never was. Furthermore, you must be aware, even though you are in the aid industry, that Governments have all sorts of other priorities for public expenditure and in times of stringency like this they have to weigh up these priorities all the time. This is removing an element of flexibility that any sensible Government surely needs to have.

Alex Cobham: To be fair, it is a flexibility that is relatively small compared to the whole budget and in addition it is flexibility in an area where the evidence is extremely clear that one of the things that does the most to undermine the value of aid for countries that receive it is a lack of predictability. By tying this in, the UK commits, in a way that has very little impact on its broader budgetary flexibility, to give aid that is likely to be much more predictable and therefore much more beneficial. As Patrick says, that allows you to move away from the argument about more or less aid and to focus very clearly on the value and the return that is coming from that aid.

Q223 Lord Shipley: Do you need legal force to make it predictable? As an example, on building consensus internationally, is having that as a target not sufficient if you are moving increasingly towards outputs and results?

Patrick Watt: The legislation increases the likelihood of the target being met, and if people are agreed that meeting the target is important—now, if people do not agree with the idea of meeting the target then obviously they are not going to be convinced by the case for legislation—and legislation increases the likelihood of that target being met, for the simple reason that any Government will have to report against that target, and so there is an element of political exposure and embarrassment if they fail to do so, then I think the legislation is a good thing. It simply increases the likelihood that that target is met. It locks it in. It shifts the terms of the aid debate. It is a commitment that was made by the coalition Government to pass this Bill. It was a commitment that was made by the Conservatives in opposition, so really the question now is whether election pledges and the coalition business plan should be followed through or not. This is where we are now with the 0.7% Bill.

Q224 Lord Forsyth of Drumlean: Just on that point, if you enshrine something in legislation, that means you need another Bill to put it right if you want to increase it. It set it in aspic. What I do not understand is that, when you say the coalition Government have done this, they have done this because agencies like yours have campaigned for it. There has been a big public campaign to sign up to this target, but you have told us that this is a target that is actually based on a 1% demand way back in the 1970s, when the world was rather different. So, if you look at it from the other point of view, are you not selling yourselves short arguing to set in aspic a target that you yourselves acknowledge is based on nothing more than what you thought you could get based on what was being argued about in the 1970s?

Alex Cobham: What was originally argued about were the structures of global trade, in particular the damage that they did to developing countries' ability to mobilise revenues, and 1% came from that analysis. To some extent, because the world has changed, looking back that seems now an arbitrary figure, and 0.7% no less arbitrary, but it is a figure around which there is an international political consensus.

Lord Forsyth of Drumlean: But you are not in the business of consensus. You are in the business of getting the most effective aid programmes into the developing world. So what on earth are you doing arguing for something you acknowledge as being arbitrary being enshrined in legislation? Surely that is a complete undermining of what you should be doing.

Alex Cobham: We are in the business of development rather than aid and I want to be clear on that; development is something much bigger than aid. The World Bank, for example, refers to figures that the illicit outflows from developing countries are something in the order of $8 to $10 for every $1 of aid that goes in; there are structural issues here, now, that are much bigger than they were when the 1%/0.7% discussion was going on. It is policy responses to them that are the beyond-aid agenda that is terribly important. Part of the reason to support legislation, in a sense, is to close this argument and allow greater focus on the beyond-aid, as well as greater focus on the effectiveness of aid itself.

Patrick Watt: Just on a point of clarification, the draft Bill, when I saw it, does not establish 0.7% as a ceiling; it is a floor. It is not about preventing a Government, if it chooses to do so, from going beyond 0.7%, as, for example, the Norwegian Government has done.

Q225 Lord Lipsey: You say there is an international consensus for 0.7%—there is an international consensus to sign up for 0.7% and then there is tacit international consensus not to pay it over. Honestly, Norway and Sweden are great countries, but they are not representative of the international consensus; the same is true of climate change targets and lots of other changes. This is how international affairs work. The peculiar danger of this, from the point of view of supporters of aid, is that there is not a consensus in our country for it. There is a two-to-one majority against signing up to this target, according to the YouGov target. When this Bill comes forward, I confidently predict that the *Daily Mail*, the *Daily Telegraph*, and the *Daily Express* will rip into this with all sorts of selective examples of failures in aid and that it will create one of those public storms with people furious that their Government is spending the money on these wasted projects when it could be spent it on helping them here at home. Therefore, it will prove to be a highly counterproductive target in the long run, if not in the short run. Does that not worry you?

Max Lawson: Yes, that does worry us enormously. In some ways, we are very, very lucky in that, of all the sectors of government spending, this is the one that is set to increase during the Spending Review period. We are conscious of the fact that the majority of that spending increase is going to come in the final year. For the Chancellor, in March 2013, announcing a 30% increase for British aid is going to be a tough call for any Chancellor in any economic climate, so we are very, very painfully aware of this. We are very conscious of the polling; we are conscious of the fact that the British public, as you quite rightly put it, has in some polls a two-to-one majority. The polling shows you some very interesting things about people's perspectives, particularly their perspective about just how much money is given by Government; consistently they quite significantly overestimate the amount that is given. In polling, if you tell people just how much of their taxes are going, then people are much more amenable to what is being suggested.

But do we have a job of work to convince the British public that these taxes are well worth the investment? Yes, we do and we work very hard to do that. That is why it may sometimes sound like we are all on the side of DFID, because this is one point where we share their desire to make the case for aid with the British public. I would reiterate that we should be very proud of our public, in comparison to those in the rest of the G7, in that we have this significant support for the development effort; it may not be as convinced of the DFID effort as it is of development full stop, but if you look at the fantastic response to things like Comic Relief, the response to the famines, the food crises, and the disasters, we have a very, very generous public, who are very interested in this endeavour. It is our job to make the case to them that their taxes should be employed in this way. It is a long answer but, yes, we are worried and trying very hard to make the case.

Patrick Watt: I just want to reinforce the point that Max made that there are two issues. The first is that there is sometimes a disconnect between people's support for the UK Government giving aid and people's support for development. We know that the UK's public is the third most generous public of any OECD country in terms of its response to development and humanitarian appeals. We know there is a very high level of engagement in development issues among the public in the UK in comparison to most other countries. There is also, as Max was saying, this mismatch between what the UK gives and what people think we give in terms of public spending towards development. We carried out some polling with Ipsos MORI back in 2008, where, on average, people estimated that 16% of the public purse was being spent on development, when, in fact, it is 1%. When people realise that it is 1% then, as Max was saying, they are rather more supportive. Part of the challenge is to give the UK public an accurate picture of the UK development effort, often in the face of some very unhelpful commentary from some sections of the media.

Q226 Baroness Kingsmill: We have been talking about the donor countries, but some of the poorest countries find it quite difficult to absorb the aid. There is an issue around the way in which development aid can distort economies and undermine political accountability. I wondered if you would like to discuss that a little for us.

Max Lawson: I absolutely agree. I lived and worked in Malawi for some years and I saw the impact of different types of aid. It comes back to this issue of quality. When aid is in the form of multiple and complex projects, of which there sometimes can be hundreds in a particular ministry, then it is remarkably difficult to absorb that aid in an effective way and in a way that has any form of plan around it. It is often wasted, particularly when you see this changeability from year to year and projects that do not last more than one or two years. That is why we would campaign consistently on the quality of aid as much as the quantity. If you see long-term predictable aid that is generated and disbursed through using the plans of Governments, and preferably the budgets of Governments too, then you can really absorb a significant amount more and I think the evidence shows that. British aid has been at the forefront of doing that. A good example would be debt cancellation. People do not see debt cancellation as an aid effort, but it was de facto the same thing. It was a significant transfer of a large amount of resources to some of the poorest countries in the world. The evidence shows that it was spent very effectively in the vast majority of cases and it was spent building the schools and training the nurses that we all want to see. That is the kind of aid that can really be absorbed.

Alex Cobham: The only thing I would add to that is to refer back to the evidence that Rachel Turner of DFID gave on the absence of evidence of Dutch disease or exchange rate appreciation increases after 2000.

Q227 Lord Forsyth of Drumlean: Is corruption the inevitable price we have to pay for getting aid to the neediest people?

Patrick Watt: I think the short answer is no. I do not think corruption should be tolerated in the UK programme any more than it should be tolerated in any other departmental spend in the UK. We know that you will not entirely eliminate corruption in the UK—there is corruption in the UK—nor will it be entirely eliminated in developing countries where we give aid, but what we should do is take measures to minimise and militate against it. You have to take every possible step to do that. I think ensuring transparency and accountability around aid programmes, ensuring good financial management systems, where Governments cannot be trusted to spend the aid effectively, finding alternative channels for that aid, are all hugely important, but I do not think it should be used as an alibi for not giving aid.

Q228 Lord Forsyth of Drumlean: If that is the approach, why have we been so conspicuously unsuccessful?

Patrick Watt: Well, have we?

Lord Forsyth of Drumlean: If you look at the levels of corruption that have occurred in some countries, in respect of the aid programme, I think it would be reasonable to conclude that we have not been particularly successful.

Patrick Watt: You could argue that where examples of corruption have been identified and aid has been suspended—if you think of the example with the global fund against AIDS, TB and Malaria in Uganda last year, where the audit process identified corruption and funding was suspended—that was a vindication of the anti-corruption measures that accompanied that aid. I do not think we should automatically assume that because corruption has been uncovered that denotes a failure of the aid programme; in fact, it could denote the opposite.

Q229 Lord Forsyth of Drumlean: Okay, but perhaps I could take another tack. Given that there are enormous costs of doing business in fragile areas and delivering these programmes, by the very nature of the environment in which you are operating, there must be a point where the cost of delivering that aid effectively outweighs the benefits. How do you go about factoring that cost-benefit analysis into the design of your programmes?

Simon Trace: You have to be looking at the outcomes for poor people and what you are achieving. That has to be the bottom line all the time. We have worked in a number of cases in fragile environments, including Darfur and Sudan for 30 years on development and not relief; that is an environment where money is generally not going through state facilities but it is going via NGOs. We have been working with local communities, often very small women's groups and associations of tradesmen, like blacksmiths, and helping build their capability and capacity to provide the only development push in that area and to provide a picture of what might be different, were there peace and civility there.

Q230 Lord Forsyth of Drumlean: Sorry to interrupt you, but when you say you have to concentrate on the outcomes—yes, you have to look at the outcomes, but do you not have to look at the costs of delivering these outcomes? My question is, really: how do you assess what is reasonable?

Simon Trace: I guess what I was saying was that you have to look at the costs in relation to the poverty outcomes that you are achieving. That has to be the bottom line all the time.

Lord Forsyth of Drumlean: And the model is?

Simon Trace: The model will vary according to the situation, so in a number of fragile states, as DFID and a number of others have chosen, they may bypass traditional government structures and use civil society to deliver aid until such point as there is confidence in government again.

Q231 The Chairman: Listening to those answers, it does seem to me that an outsider here would feel there is degree of complacency in your approach towards corruption—that corruption is inevitable and you just have to take that into account. Surely, in your programmes, you build in procedures to track it down and stop it.

Simon Trace: Absolutely, and I was in no way implying otherwise. There is a difference between expecting and accepting. Obviously, in regimes where there is very fragile governance, then the opportunities for corruption would be higher than where it is very strong; but even in the UK, as Patrick said, we have plenty of examples of corruption and fraud. We need to make sure that we have the appropriate controls in place to make sure that we can account for every penny that we spend, and we do that.

Alex Cobham: It is also worth saying that we, as agencies, are much more rigorous now than we were 30 years ago in auditing the relationships that we have and the flows of money that go through our organisations, just as DFID is. Also, there is a proactive agenda that is very strong here. This is not only about trying to fight corruption within specific programmes or projects. There is a much broader piece of work, which is about empowering civil society and raising transparency to try to challenge the structural causes. That is somewhere where I think we do need to give DFID a pat on the back in a couple of areas. The first is in supporting technical capacity-building for tax authorities, which has been extremely important in helping to challenge the illicit flows out of countries. The second, which in some ways is a world innovation, is that DFID supports—effectively funds entirely—the team within the City of London police force, whose job is purely to track down and repatriate stolen assets from developing countries. This is much more important than the money that is simply sent back, although in a ratio as to how much it costs, they do very well on that measure. Actually, it is very important because it sends a signal that the City of London is no longer simply open to money from any corrupt source, in particular the developing countries. That message, and the multiplier effect that it has through other donors as they start to look at their own financial systems, is extremely important.

Q232 The Chairman: I was struck in your evidence to us by the paragraphs you had on addressing capital flight, and you give some very compelling figures about Christian Aid's research looking at transfer mispricing and false invoicing, which cost developing countries $160 billion a year in lost tax revenue, some one-and-a-half times the global aid budget. You have obviously identified this as a key concern and I wonder if you could say a little bit more about what you think can be done to put it right.

Alex Cobham: One key thing from the research that Global Financial Integrity in the United States did—and that the World Bank often quotes—is that, although we tend, sitting over here, to think of corruption as being about dictators stealing assets from their own countries, in fact it is estimated at being something like 3% of the global total of illicit flows. Corporate tax evasion is around 65%; that appears to be where the majority is and the remainder is largely around drug and human trafficking activity. So what you get is a sense that the crucial issues to challenge the scale of the problem are around the international transparency measures that apply to trade. On the one hand, that is about the transparency of company's accounts and whether it is possible to trace through if profit is being shifted, particularly out of developing countries; but the other element is about the transparency of tax havens or secrecy jurisdictions. For example, in the British Aerospace and Tanzania deal, there was a Jersey element. Jersey has become more transparent, but there are still issues. There are also issues in the UK. We ourselves are not perfect with regard to the amount of information we exchange with others or the transparency that we offer. There is progress in that direction though. The more that we can drive that forward, the more we challenge those global structures that support corruption at every level.

Q233 Lord Forsyth of Drumlean: To put this in tabloid terms, are you saying that what we should really be worried about are corporates rather than the tabloid dictator buying himself a plane and a fleet of Mercedes. Is that what you are saying?

Max Lawson: In tabloid terms, what we are saying is that the bribe-givers are at least as tabloid-interesting as the bribe-takers. A lot of them are within the remit and control of the Governments of rich countries. They are often involved in tax avoidance and tax evasion, and that is quite a story, I think. I absolutely believe that the bribe-takers—the corrupt dictators—should get as much press as they do get, but there is another side to that story and many of our businesses and the businesses of the rich world are heavily involved in it, yes.

Alex Cobham: I do not think it makes sense to say that the numbers alone, which are, in any case, estimates, should be the only determinant of the amount of emphasis that we put in different areas. Although the numbers are terribly eye-catching and terribly important, in some ways it is the social rather than the economic damage that is done that is the most important. Study after study shows that tax compliance, and a sense of a social contract between the state and citizens, relies very heavily on the perception of the behaviour of others. In particular, it is large companies; it is political leaders; it is the elite. If each of the aspects of corruption around illicit flows contributes to everyone else in a society thinking that there is no reason for them to comply by paying taxes or, in other ways, by behaving socially, that is ultimately much more damaging. The end of that road is a completely failed state and a failed society. We should not think that the numbers alone tells us where all the emphasis should be, although they are certainly a guide to where it should be.

Q234 Lord Lawson of Blaby: We have had ample evidence of appalling corruption in a number of countries that are in receipt of aid and in countries where you operate. One example is what Sir Edward Clay had to say about Kenya, but that is not, by any means, alone. Can you tell us what your organisations are actually doing, actively, to fight and expose corruption in these countries and what support you are actively giving to those brave souls, and there are some, in these countries, who are trying to fight it themselves but are badly in need of assistance?

Max Lawson: Certainly, that is an area of significant growth in our work over the last 10 years. Certainly, when I lived and worked for Oxfam in Malawi what we focused on primarily was, as Alex was talking about—

Lord Lawson of Blaby: I am sorry, but maybe it is something you can send us a note on, if the Chairman is interested; I am interested not in your generalities, but in what specifically you are doing in this area in those countries.

Max Lawson: If you pardon me, I was just about to give a concrete example, which is a concrete example of something that we do in a number of countries. That is working with church groups, working with civil society in countries and working with the IMF, quite interestingly—because of IMF programmes and because of debt relief, there is way more budget transparency in the majority of sub-Saharan African countries now. People now know what the initial budget allocations were. You are seeing, through DFID programmes, output-based budget programmes, so they will say that every child in the country should have six exercise books this year, which is one of the targets in Malawi. Our job is, through civil society and through the citizens of those countries, to publicise the commitments of Governments and to help people have the ability and the power to hold Governments to account. Those are very concrete examples of what NGOs can do, but it is very much about the citizens of those countries. They are the people who are most angry about corruption, in my experience, having travelled all over Africa; they are the people who really want to see this rooted out and dealt with. Giving them the space and the power to engage with those discussions, whether it is at local government level or national government level, is something that we do, that Christian Aid does, and that Save the Children and all the others engage in. It is quite a significant growth area over the last 10 years, definitely. It was off the back of debt relief in fact; it was a real perception on the part of African citizens that they had been given this gift of debt cancellation that many of them had campaigned for with their fellow campaigners in the north and they wanted to see that money spent well. That is where you saw this interest in accountability and the monitoring of budgets.

Q235 The Chairman: Mr Cobham, going back to some of your answers, I fully accept your point about the impact on the atmosphere generally in the country of corrupt practices and so on. On the actual concrete question of the amount of money that flows corruptly, you gave some graphic figures, but quite a lot of your examples, I think, were from corporate transactions rather than direct aid. Is there any evidence that aid from your organisations or from Governments is involved in this illicit capital flight?

Alex Cobham: Where it would feature would be in two areas. One would be through government aid funding being used in procurement processes that are tainted by tax evasion or directly through state figures stealing assets. There is certainly very little evidence beyond the individual stories that often, as discussed, make it into certain parts of the media here. In terms of the scale, even if you add up all of the established and now quite well accounted cases of dictators like Marcos over the years, and where their families' money went, it is trivial compared to the scale of illicit flows each year of something like $1.2 trillion. What we are seeing is flows that are much bigger, partly because they are largely commercial, than anything that relates to what are, I am afraid to say, in total, the relatively small aid flows.

Q236 Lord Best: My question is about private sector investment. I am wondering whether there is a divergence between your collective views and that of DFID on whether one should encourage more of this or whether, quoting the Christian Aid evidence, foreign direct investment "has at best no impact on growth and a negative impact on human development"? Are you, the NGOs, going in a different direction from DFID on this one?

Simon Trace: I think we would probably all agree that the private sector is an important engine of growth and development in all the countries in which we work. I think where we might disagree is around the emphasis that DFID currently has on the scale of the private sector that needs support. We—certainly Practical Action—would be just as interested in seeing support going into the small-scale, domestic private sector, which is going to be the key employers in those countries and provide opportunities for work for the poor, for low-income men and women. We think that needs to be paid as much attention as investment and support into large-scale international private sector engagement in the developing world. Practical Action would be happy with the idea of supporting private sector development, but we would want to put a particular emphasis on the small-scale private sector and those that are going to be most likely to provide employment opportunities and livelihoods for poor women and poor men.

Alex Cobham: Just to come back on the particular quote, which I have now found, it is specifically that the evidence relates to "least developed countries". We are talking about foreign direct investment not to developing countries in general but to those most fragile states, where the type of foreign direct investment that you tend to see is overwhelmingly in the extractive sectors. Where that is coupled with what are, in general, very weak Governments in any case, you simply do not find consistent evidence of benefits. In some cases, as that quote shows, there is actually a step back in development, but that is quite a specific case.

Q237 Lord Lipsey: In support of this incredibly strong proposition that reads, "FDI has at best no impact on growth", you cite a single very elaborate paper that does not refer to stressed states or anything of that kind; it is supposed to be a general survey of all the hundreds of studies that have been done in this area. The paradox of this is slightly shown because the conclusion of the study says FDI does not make any difference, but it also says that the level of democracy makes no difference to growth. Your evidence does not say that the level of democracy does not make any difference to growth, but that is what the paper concludes. Do you think you have really taken a rounded look at the impact of FDI, or is this just prejudiced?

Alex Cobham: As I have said, this refers to "least developed countries", rather than developing countries in general, so it is a very particular subset. In terms of the point on democracy, I think often you find, looking at cross-country empirical studies on democracy, that there are two problems. Firstly, the indicators typically used for democracy are not necessarily ideal, which raises questions over these empirical results, but, secondly we might not want to pursue democracy because we think it is good for growth. We might think that democracy is good for people. I am not sure that that is a result we would have particularly drawn out, certainly not in this context.

Max Lawson: One really practical consideration that I think we have learnt in the UK as well is that bureaucrats are pretty poor at picking winners in the private sector. I worry a little bit, just from a pragmatic point of view; I think DFID should put all of its efforts or the majority of its efforts into creating the conditions for growth, rather than getting heavily involved in the private sector development strategies of developing countries. I would remind us again of this issue around the fact that investments in primary, secondary and tertiary education and in free healthcare are incredible contributions that our aid can make to give people the ability to do what they are best at, which is setting up their own businesses and getting involved in private sector development. It is more a note of caution that, in a desire to get the private sector going, very often the contribution of aid is not in the industrial policy or picking winners.

Q238 Lord Tugendhat: Can I come back to this point regarding the Christian Aid evidence that FDI has "at best no impact on growth and a negative impact on human development in the least developed countries". I was for some years, quite a long time ago now, chairman of a company called Blue Circle Industries, which was a big cement company. It had operations in, inter alia, Nigeria, Zimbabwe and Kenya, which I remember visiting. I was very struck, when I visited these operations, by the extent to which the Blue Circle operations had led to the growth of indigenous supplying companies, people who were providing all manner of services and supplies, from which they gained a great experience and a vast number of skills. Had we, or any other similar company, not been there, their scope for developing these supply industries would not have been there either. Now, of course, I do not know how you defined human development, but it seemed to me that this was a very tangible example of promoting human development. I am not saying it was done for charitable reasons—it was mutually advantageous—but it certainly makes me very doubtful of your contention.

Alex Cobham: This is a really good example of the kind of model that you can see real hope for. Increasingly in the last few years we have been working on the ways in which the supply chains of multinational companies can be tweaked to have a much broader development impact. Where you do not see those benefits is where, as I said, particularly in the extractive industries in fragile-state conditions, where typically you will rely on capital inputs rather than looking to source any material locally, you will provide relatively low-skilled and often dangerous labour opportunities, but little more than that. So there are relatively few positive spillovers into the economy and there is often a risk of mis-pricing of the product, so that a relatively small share of the economic activity stays in the country. It is a very different situation from the one that you are talking about. Obviously, increasingly, as with all NGOs, recognising the importance of the private sector in successful development, we are looking to work more and more with companies on the way in which their operations—again not for charitable reasons, but because it makes good business sense—can be improved in a way that also improves the development impact.

Patrick Watt: I think there is a risk in DFID's approach, and in a lot of the discussions about the private sector and development in this country more generally, of over-emphasising the role of foreign direct investment and of UK companies. Actually the bulk of private sector activity and the bulk of private sector growth in developing countries are going to come from small and medium enterprises in developing countries themselves. What is important is a balanced approach. There is sometimes a risk that big organisations like DFID naturally choose other big organisations as their interlocutors. They find it easier to have a conversation about private sector development with Unilever than perhaps with a group of small agricultural producers in rural Malawi. But ensuring a balance in the approach is critical, as is not losing sight of what private sector activity is a means towards. We should not lose sight of the importance of ensuring that people in poverty have access to markets—labour markets, product markets and credit markets—that actually enable them to participate in, and take advantage of, growth. That is really where the focus needs to be in these discussions.

Q239 Lord Lawson of Blaby: So, just to clarify, you made a mistake when you said that FDI has a "negative impact on human development in the least developed countries". What you meant was that DFID's promotion of FDI is less effective than other ways in which they could spend the money.

Patrick Watt: I was not trying to speak for Alex there. Alex can speak on what is in the Christian Aid submission, which I have not read.

Alex Cobham: I think the quote reflects the findings of that piece of the literature, but specifically applying to least developed countries, rather than more broadly. That is the distinction on which that study rests.

Lord Lawson of Blaby: So it is just one rather dodgy study that you have based your important generalisation on, have you?

Alex Cobham: I would be interested to hear your critique of the study.

Lord Lawson of Blaby: It is just one.

The Chairman: It is not an illustration that you could take as typical of direct private investment in many countries.

Max Lawson: I would absolutely underline what Alex is saying. The majority of investment, particularly in Africa, in the poorest countries on the planet, is in the extractive industries and that is some of the least useful in terms of the spin-off effect we are describing here. That is not just that study; study after study has shown that. Mining companies are some of the most egregious in avoiding tax, and basically taking resources and leaving. That is not just about this study; this is not a point about the broader private sector as a whole, but it is a recognition that that is the vast majority of FDI into Africa at the moment. Often, it is not from British companies; it is from Chinese companies and Indian companies. This is not particularly having a go at the UK in any way, but that is the reality of foreign direct investment.

Q240 Lord Forsyth of Drumlean: Just on that point, I went to lunch the other day with quite a well known African economist, who has looked at aid, and I found myself on the wrong side of the argument, because she was arguing very passionately from her experience of Africa that what the Chinese were doing in Africa, which is very much what you are being critical of, in terms of going for raw materials and so on, had had a very beneficial effect because they were building roads and infrastructure and so on and so forth. So when we talk about the private sector, in some cases it is the state sector for other countries, and China is doing this on an enormous scale. Can I take it that you are very critical of that as well?

Max Lawson: No, I am not saying that.

Lord Forsyth of Drumlean: What are you saying?

Max Lawson: I am saying that there is a significant investment in extractive industries in Africa and much of that is not beneficial to Africans. Is that all that China is doing in Africa? No, it is not. The detailed studies of what China is doing in Africa show that they have got about 10 different agencies within the Chinese Government investing in Africa in different ways. I recently saw roads being built in northern Malawi, which are beneficial, are accessing communities and are being built very rapidly; Governments are quite clear that that would have taken them 20 years to negotiate with the World Bank and now they have a new road to look at. So it is a mixed picture when it comes to Chinese aid. I am saying that the extractive sector in particular is renowned for not being helpful for poor countries.

Q241 Lord Forsyth of Drumlean: I am just confused now. I thought your argument was that people come in there, and they go in in order to take out raw materials.

Max Lawson: In some instances, that is exactly what they are doing, yes.

Lord Forsyth of Drumlean: That is what the Chinese are doing as well as some people in the private sector.

Max Lawson: In some instances, yes.

Lord Forsyth of Drumlean: In order to be able to do that, the Chinese have got to build roads and infrastructure, which have had a benefit.

Max Lawson: I think it varies. If you look at the road that I was talking about in Malawi, that was a commitment the Chinese Government made to the Malawian Government in return for other things. This was not a road to the mine; this was a commitment they had made to their development plan, which was a rural city that had never had any solid access. The fact of the matter is that the Chinese aid to Africa is very opaque; it is very hard to ascertain exactly what is going on, but it is certainly not entirely terrible. However, it is quite right—I am not sure who you were speaking to—that it has been beneficial in many instances and they are very focused on infrastructure. This is an area that has been neglected.

Q242 Lord Forsyth of Drumlean: As for the benefits that you are attributing to the Chinese involvement in Africa, you appear to be, unless I am misunderstanding, saying that it does not apply to foreign direct investment by private companies.

Alex Cobham: The particular study referred to in our submission relates, as I said, to the least developed countries, but it also is from 2006, so the data is presumably before 2003 and 2004, at best, going backwards, so it would not necessarily capture a great deal of China's involvement in Africa. To tie this back to something we were talking about before, it is worth thinking—although we should be wary of casting Chinese involvement in Africa as monolithic—that in a lot of cases that commitment to build roads and other infrastructure as part of the deal to access natural responses is a response to the problem of corruption that we have been talking about, so it is a guarantee that ordinary citizens will see tangible benefit for signing away the rights to those resources. Although we have some issues around it and the transparency of those deals and so on, actually as a first-move response to the problem of corruption when it is simply a cash flow to a Government, you can understand why that has been popular in certain instances.

Q243 Lord Lawson of Blaby: In her very powerful, and well documented book, *War Games*, which I am sure you have read, the Dutch journalist Linda Polman has pointed out that what happens in practice is that many NGOs are drawn into complicity with some highly undesirable political regimes, maybe because they feel that they will not be permitted to operate in those countries if they are not complicit. She gave as one of the examples the refugee camps in the so-called Democratic Republic of Congo, following the Rwanda genocide, when in fact these camps were being run by those responsible for the genocide. She has a point, doesn't she? What are you all doing about it?

Max Lawson: She has got a point. Having gone head to head with her on many a radio programme and many a debate, I think her points are exaggerated. We can give you a detailed critique of her book. I think some of the points are well made about the Interahamwe and their camps following the Rwanda genocide. I think a lot of lessons have been learnt about that. We are consistently working in very difficult political environments, which is what the question is about. Right now, we are in the position where we are negotiating with al-Shabaab because we want to get to the million people who are facing famine, so these are incredibly difficult decisions that are made day in, day out by our humanitarian staff. Do they make the wrong decisions in some instances? I am sure they do. Would we want them to not even try? I am not sure that is the case. As I said, I am quite happy to furnish you with a detailed critique of her book. Her points are well made in some instances, but some of them are not.

The Chairman: It would be helpful to have a detailed critique if we could, thank you.

Patrick Watt: Just to add to Max's comments, there has been a lot written and said, including by humanitarian NGOs themselves, about eastern DRC. The fact is that by running the camps they ended up providing an operating base for the Interahamwe, in some cases. I think lessons have been learnt from that about applying a "Do no harm" principle in humanitarian emergencies. We face often, as Max was saying, very difficult choices. The alternative, let us be clear, in eastern DRC, by not going in, would have left many, many people vulnerable to disease, to starvation and to other risks. The moral choices and the practical choices facing humanitarian NGOs in contexts like eastern DRC and Somalia are not easy ones. We do weigh up, on a case-by-case basis, the risks and benefits to affected people of us operating and recognising that sometimes making political compromises can be a risk too far. It is very hard to generalise. Every emergency we operate in has its own particular characteristics.

Q244 Lord Lawson of Blaby: The balance you have to weigh up is not just, although it is of importance, the balance between the cost of helping al-Shabaab, whatever it is, a most unattractive organisation, and the cost of not doing it; it is also whether there is some other poor country where there are poor people, where you do not have to sup with the devil to that extent, which indeed might well be bolstering al-Shabaab or whatever, so taking a longer view it is maybe not very desirable. Can you give us concrete examples of where you have decided not to proceed because it would mean complicity with a governing authority? I say "governing authority" because it is not always an actual Government; it is those who are in power in a particular area.

Patrick Watt: I can give an example; it is actually not with Save the Children but with World Vision, which is another NGO I previously worked with, where, during the last election campaign in Zimbabwe, World Vision was given the option by ZANU-PF of being allowed to distribute humanitarian aid, but through Zimbabwean army channels during the election campaign. We did not trust that that aid would actually be used for development purposes so we declined the invitation to do that. That would be a specific example, but there are plenty of examples.

Lord Lawson of Blaby: There are plenty of examples?

Patrick Watt: Yes, of those choices made by development NGOs.

Lord Lawson of Blaby: It would be interesting if we could have a note from you, collectively or whatever, giving plenty of examples, not just the one.

Q245 The Chairman: Or perhaps from each of you. We have talked a little bit about China so far, but I would like to ask you more widely what implications the emergence of all these major donors—China, India, Brazil—have for the British and international aid effort and in particular what implications they have for your work.

Patrick Watt: There are a number of implications. One that has already been discussed is the fact that new donors entering the aid industry, like China and Brazil, are offering additional resources to countries and, in some cases, they are offering insights from their own experiences of development. The experience, for example, that Brazil has had in its social protection programmes of making cash transfers to poor households to make incentives for them to send their daughters to school and creating new opportunities for poor households to develop their livelihoods can offer some very useful insights for other developing countries. I think there is both the money and in many cases the knowledge that new donors bring to the development effort, which can be very valuable.

I think there are some other effects. One is that new donors can often weaken aid conditionality, which some people think is a good thing and some people think is a bad thing. They break the cartel of the OECD donors and provide alternative sources of funding. It is unlikely that the Government in Uganda, for example, could have taken the line it has taken with the Western donors if there had not been alternative sources of funding available from the Chinese. There is also a risk that new donors fragment efforts. If they come in with their own planning, reporting procedures and systems, it just adds to the multiplying demands on the time and capacity of recipient Governments. I think there is also a question about whether new aid is challenging some of the models of giving aid. The Chinese very explicitly give aid on a mutual-interest basis. They talk about mutual interest. They expect to benefit economically from the aid they give and they are also very clear that they expect political recognition for China rather than Taiwan in exchange for aid. That is all very much above board. It is a very different way of giving aid from the model of the north-west European donors, for example. In all of those respects, new donor entrants are changing the landscape.

The Chairman: Does anyone else want to comment on this?

Max Lawson: I think I had better say something. I think we can exaggerate the scale. I think it is worth mentioning that the vast majority of aid, and particularly the kind of aid that is really making a difference, is still predominantly coming from European Governments. Therefore, while this is an important development, and it is very much something that we need to keep an eye on, it is not going to be something that substitutes for the European efforts any time soon. I would also add that very much our concern at the moment is that

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Q246 Baroness Kingsmill: It was that point that I wanted to explore a little bit further. How far do you think it is reasonable for Governments to have conditionality in relation to aid? Are there any circumstances in which you would accept conditionality?

Max Lawson: Definitely, if we come back to Lord Lawson's point about the issue of corruption, it is conditionality from the IMF and the World Bank that has forced Governments to be more transparent and more open about their books and which has set in train a whole sequence of accountability activities that we have been involved in as NGOs. It is a good example of conditionality that we would wholeheartedly support and that makes a really big difference. Where we would be against conditionality is where, again coming back to this private sector point, whether it is bureaucrats in Washington or London trying to dictate detailed economic policy to the Government of Tanzania, we just do not think that is effective and we do not think it has worked historically. It is just not the way to give aid. It depends on the type of condition, but we are certainly not against conditionality full stop.

Q247 Baroness Kingsmill: What about things like climate change or deforestation, which may be in the interests of the developing country but not necessarily in the interest of the Government giving the money? Do you think it is reasonable for a Government to say, "This is our taxpayers' money and this is what we think would be in their interest as well as in the interests of the recipients"? To what extent, if at all, do you think we should be thinking like that?

Max Lawson: Those are two slightly different questions. On the first point, it is perfectly reasonable to be open about the outcomes that we want to achieve with our aid in country X. If it is getting every child into school or if it is a transfer to more sustainable energy use, then it is quite reasonable to sit down with a Government, particularly a democratically elected one, and say, "Where are the shared objectives here? This is where we would like to support you." That is a very different set of conditions from ones that are more about the self-interest of Britain in terms of trying to reduce emissions or mitigate climate change. Again, if it is an open and transparent discussion—it is rarely amongst equals, because we are talking about some of the poorest Governments on the planet, so we are not trying to pretend that there is not a power dynamic there—particularly in the framework of a global agreement, where we are all trying to reduce emissions, it is quite reasonable to discuss it.

Q248 Baroness Kingsmill: Any other areas that you can think of?

Max Lawson: No, as I said, I think that, in terms of agreeing social policy outcomes, that would be fine.

Baroness Kingsmill: Women, for example, women and girls? Some countries, which may be recipients of development aid, do not treat their women and their girls particularly well. Would that be an element of conditionality? Would that be appropriate?

Max Lawson: I think that, in terms of respect for human rights, that is perfectly reasonable as an outcome. I would be cautious about an approach that had that as an on/off switch because often there is a progressive realisation of rights, particularly social and economic rights. I think we would have to be careful about the way that they are articulated, but I do think it would be reasonable again to say that we believe, for instance, in the rights of homosexuals, which is a major, major issue in Africa at the moment—you saw the announcements this morning—and that we want to see action taken or a debate in a country, and that we need to see this discussed. As a fundamental human right, it is quite reasonable for us to ask for that. You see the Nordic donors doing that all the time.

Baroness Kingsmill: And could we withhold aid if that was not forthcoming?

Max Lawson: My personal feeling is that, in almost every instance, withholding aid achieves the opposite of what you want to do. I am watching with horror the slow-motion car crash that we are seeing in Malawi at the moment, where the President, who had been doing a great job, has basically, as far as we can see, gone a little bit mad and is very sick. We are seeing a situation where he is getting very, very intransigent and he is looking across the borders at Zimbabwe and is thinking and acting in a very similar way. We are withdrawing our aid, as the UK, and all this is succeeding in doing is making him more angry, so that he is impinging swingeing cuts on his population to pay for that. I really worry that quite often a kneejerk reaction, and the removal of aid entirely, only hurts the poorest people, and it does not really affect the people who are abusing the rights in the first place. Am I saying we should not do it? No, but we have to look at the impact of what we are doing here. It is about weighing the different rights up against each other. I have seen very closely the health programmes in Malawi that are being funded by our taxes; this is not an issue of corruption—the money is not being stolen—but it has been stopped by the British Government because of violations of civil and political rights. So, I can think of mothers who no longer have midwives that are being paid and are not getting their rights to health as a result of that decision. Again, it is one of those very difficult balancing acts.

Q249 The Chairman: Can I just ask one last question on this subject to Mr Cobham? It is about the part of your evidence where you say, "There are clear concerns that new debts built up with emerging powers could have a negative impact on developing countries." Then you go on to recommend: "To ensure compatibility and effectiveness of aid and other support from traditional and non-traditional donors, greater transparency is needed in the terms of agreements between developing countries and donors and businesses." Would you like to expand on that?

Alex Cobham: I think, particularly after a certain amount of debt cancellation, there is an ability for relatively poor countries to go to the market again. There can be a risk of simply building up again debts that are unsustainable and indeed may be illegitimate, especially where the way in which those debts are created is relatively opaque, so there is less opportunity for citizens to hold their Governments to account for the ways in which the borrowing is then used. That would be the broad concern. One thing that we are working on with our partners, the Jubilee Debt Campaign, is looking at the way that tax havens are exploited by vulture funds. That is another of those cases where you can see a lack of international financial transparency coincide with a lack of transparency or legitimacy within a developing country to the detriment of its citizens.

Q250 Lord Tugendhat: DFID has stressed the importance of effectiveness and value for money in its aid spending through its programme and via partners. Could you say something about the process of due diligence and scrutiny that you undergo in the development of a partnership programme with DFID? How does it apply to you?

Simon Trace: I can go through the process that we followed, if that is helpful. There were three or four stages. We were invited to submit concept notes, which were principally around information around our organisations, and we were invited to describe our fit in terms of our policies, objectives, and goals and DFID's policies, objectives and goals. There was a full application submission after that, which was looking at more detailed plans of work that we had for the next three or four years, plus evidence of transparency, accountability, results delivery, value for money et cetera. As with all engagements with DFID, most of the donors were expected to produce what is called a log frame, which has some overarching goals and some very specific objectives and activities that we are expected to flesh out. There was then a more in-depth assessment of the log frame. We had a value-for-money-through-procurement questionnaire that we had to go through. We had a due diligence check by KPMG, who looked at not just financial but also governance, programmatic processes, systems, policies, processes, environment risk management and the like. Then there were various follow-up pieces for requirements for additional information and an environment assessment, and then finally a business case that had to be put together. So from our perspective that was quite a long and thorough process before it was finalised. I do not know if other people's were the same. I think it was pretty much universal.

Patrick Watt: Yes, it is a standardised procedure, so what has just been described by Simon applies to all PPA recipients.

Q251 Lord Tugendhat: You all are in receipt of money. Can you tell me, from your personal knowledge, whether there have been occasions when similar bodies to yours have been struck off the list because they did not measure up to DFID's requirements? On the other side, do you feel that there are sometimes organisations that are not on the list and it is very difficult to break in because there is a group of people that DFID have been doing business with for a long time and newer organisations come up and you are all getting the money and they have difficulty breaking in?

Patrick Watt: Certainly NGOs fall off the list and come on to the list, so, in the last PPA, Bond, which is the secretariat for UK development NGOs, came off the list. I know that World Vision and Tearfund came on to the list, so I think that there is a regular revision of who is receiving PPA funding and who is not.

The Chairman: Gentleman, we must stop there because we have overrun our allotted time, which is a measure of the interest we have taken in your evidence this afternoon. There are some responses that you are going to give us in writing and we would be grateful for those. I thank you very much for your evidence and for all the good work that your organisations do.

Practical Action—Supplementary written evidence

During my attendance as a witness to the above inquiry on the 13th September, there were two areas where the Committee indicated it would welcome further examples of practice from the NGOs present. This memorandum aims to provide further evidence from Practical Action's own experience in this respect.

Q234 – Lord Lawson asked what our organisations were doing to help citizens of the countries we work in to fight corruption. I would like to provide one example here.

One area of Practical Action's work relates to helping poor urban populations gain access to basic services necessary for a sanitary environment, such as water supplies, sanitation, surface water drainage and waste disposal. In many cases access for the poor to such services in urban environments is dependent on their ability to hold municipal authorities to account for the way budgets are prioritised and then spent. Many of our urban services projects include work to increase transparency in these processes and ensure poor people's needs are heard and that spending then occurs in line with budget allocations. I include a brief case study from Kisumu in Kenya below as an example. The case study is extracted from our recent annual progress report.

Case Study 2: Social audits improve local government accountability and ultimately people's access to urban services

In Kenya's 3rd largest city, Kisumu, our project on Peoples' Plans into Practice began in October 2008. As well as working on delivering people's priority needs for basic services (protected springs, improved sanitation, improved drainage to reduce seasonal flooding, waste management), the project has put a lot of effort into building the capacity of local neighbourhood and ward associations, especially on social audit processes and issue based advocacy. One of the tasks these associations have taken on is the monitoring of how decentralised funds are being spent by the city council. In the past we have concentrated our efforts mostly on helping communities to have a say in how funds are initially allocated. Practical Action and its partners now inform the communities and bring them on board at the time when decisions about the projects are being made. For example, funding has been allocated to pay for the electricity connection, additional pipes and water kiosks for a borehole dug using our project funds.

The social audits revealed that perhaps a third of the projects ear-marked for funding had not been delivered at all, and there were problems with another 40%, e.g. of poor quality or incomplete finishing. The reports have had a great *impact with local politicians and project management committees who have acted swiftly to get the work back on track. Community members are excited that for once their leaders are held to account for public resources entrusted to them.*

Q244 – Lord Lawson asked for more examples from the NGOs present of how we balance the need to gain access to populations living in extreme poverty against the danger of potentially being drawn into complicity with "some highly undesirable political regimes" in order to gain that access.

The example I would like to refer to from Practical Action's work relates to our activities in Nepal during the 10 year Maoist insurgency there. In more recent times the Maoist movement has of course come into mainstream politics in Nepal, but during the insurgency period it was critical that Practical Action's neutrality and focus on serving the poor was maintained, and perceived to be maintained, by all parties at all times.

During this period large parts of rural Nepal were under the control of Maoist forces rather than the Government and access was, to a greater or lesser extent according on the location, dependent on the 'permission' of the local Maoist commander. Throughout the insurgency Practical Action continued to work in rural areas, helping communities gain access to important services such as water, sanitation and energy, or improve food security and build livelihoods. Our strategy was to continue to apply the same criteria for deciding which communities to work with and what projects to fund as we had always done. We sought to work directly with communities and to avoid having any sort of formal relationship with what were then emerging local Maoist administrations. Where we encountered resistance to working with the communities we chose, or pressure to invest in other areas, suggestions that we needed to pay a 'tax' to operate, or a request to sign a formal agreement with the local commander, we withdrew from that area. In most cases the local communities were then able to renegotiate access for us on the neutral terms we required to operate. Where this was not possible we, regrettably, did not continue.

Simon Trace, CEO Practical Action
11 October 2011

Publish What You Fund—Written evidence

This submission from Publish What You Fund to the Select Committee on Economic Affairs focuses on the relationship between better information about aid and delivering on aid effectiveness commitments. Specifically, it relates to the factors determining the effectiveness of ODA in recipient countries (question 4 in the call for evidence).

Factors that determine the effectiveness of ODA in recipient countries

1. Governments in recipient countries struggle to know with precision how much aid is invested in their country, from whom, and how it is being spent.[382] This not only affects how aid resources are utilised but it also has an impact in the allocation of their own resources. Even in the most aid dependent countries receiving the highest levels of aid, domestic resources remain greater than external support levels.

2. The issues here are two-fold: a lack of funds means that plans cannot be implemented, whilst a lack of predictability or future aid information means that government officials invest less in future planning processes. Donor 'fickleness' is, unfortunately, not an uncommon experience for recipients.[383] At the macroeconomic level, not knowing how much external aid is flowing into a country undermines macro-planning and stability thus affecting exchange rates, monetary supply and fiscal policy, potentially making poverty reduction harder to achieve.

3. Improving the transparency of aid is essential for the efficient and effective use of resources, to enhance the quality of both planning and decision-making processes and subsequent implementation. Weak aid transparency as well as planning and implementation deficiencies also undermine evaluation and learning at both the technical and political level. It is not possible to evaluate a programme's effectiveness or efficiency when a significant proportion of resources in a sector or region remain unknown.

Aid transparency, the allocation of ODA and meeting donor commitments on aid effectiveness

4. A global movement for aid transparency has emerged at a time when there is growing awareness of the importance of how aid is used. Without progress on aid transparency, key commitments made by donors to improve the effectiveness of their aid will not be delivered. Information on donor activities is a precondition for delivering the commitments of both the 2005 Paris Declaration on Aid Effectiveness and the subsequent Accra Agenda for Action which followed in 2008.[384] Transparency of future aid flows reduces unpredictability, whilst comprehensive information on the terms and conditions of aid projects is essential for removing excess conditionality. Without information on inputs, results cannot be managed or be held accountable. Aid transparency is needed for the coordination and redirection of efforts, to improve the division of labour between donors, and to better direct resources in relation to

[382] Within recipient governments the issue around lack of aid transparency has an impact on line ministries and agencies, as well as oversight bodies such as prime minister's or cabinet offices, ministries of finance, audit institutions, etc.
[383] Celasun, O. and Walliser, J., "Predictability of aid: Do fickle donors undermine aid effectiveness?", *Economic Policy*, July 2008, pp. 545–594.
[384] For more on the relationship between aid transparency and aid effectiveness see Publish What You Fund's Briefing Paper 2.

recipient countries' own efforts. Transparency is a prerequisite for effective country-led development, and ownership by recipients. As discussed in an Oxfam report, ownership means supporting effective states and active citizens' efforts to determine how they use aid resources as part of their broader development agendas.[385]

5. In order for donors to make sense of priority areas and to harmonise their efforts with others, readily-available information on existing aid funding, mechanisms and results need to be accessible. It is therefore to the donors' advantage to be fully informed in order to make the best use of the funding they are allocating, to ensure an adequate balance of investment between different donors and to maximise the impact of their own investments in the economic growth of recipient countries.

6. In recipient countries, it is not only the government that requires aid information. Greater levels of information about aid transparency benefit civil society, including non-governmental organisations, the private sector, parliamentarians and direct beneficiaries. Aid transparency in this case is a prerequisite for holding accountable not only donors and service providers over commitments made, but also to hold their governments to account over discrepancies between aid received and aid spent on behalf of beneficiaries. By exposing whether donor funds are used for the correct purpose, aid transparency is one way of helping reduce corruption.

7. While challenges remain, there is clear evidence of an increase in the quality of public engagement in aid and government policies and in their implementation as a result of this shift in approach.[386]

8. In donor countries, information about government expenditure can be used to monitor the results of government or multilateral aid spending. By providing information more publicly, donors can encourage active engagement in the aid sector. It is also essential for parliamentarians, as overseers of public funds, to be able to access more and better information about aid.

9. Better and more accurate information on aid is needed for greater levels of aid transparency. How this information should be disclosed in order to achieve the benefits of aid transparency is detailed in the following Publish What You Fund aid transparency principles:[387]

    1. **Information on aid should be published pro-actively** – a donor agency or organisation should tell people what they are doing, for whom, when and how.
    2. **Information on aid should be comprehensive, timely, accessible and comparable** – the information should be provided in a format that is useful and meaningful.
    3. **Everyone can request and receive information on aid processes** – ensure everyone is able to access the information as and when they wish.

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385 *Ownership in Practice: The key to smart development*, Oxfam America, 2009.
386 McGee, R. et al. "Assessing Participation in Poverty Reduction Strategies: a desk-based synthesis of experience in sub-Saharan Africa", IDS Research Report 52, Institute of Development Studies.
387 In collaboration with freedom of information, governance integrity and aid effectiveness organisations, these principles were designed to be applied by all public and private bodies engaged in the funding and delivery of aid, including donors, NGOs and contractors.

4. **The right of access to information about aid should be promoted** – donor organisations should actively promote this right.

10. To obtain the full benefits of aid transparency, the information provided needs to be meaningful. Without the ability to compare the flows and activities of different actors it is not possible to start making judgments on the best use of resources. For example, for a UK taxpayer or parliamentarian, just knowing how much UK money is being spent in Afghanistan and on what is of limited use. To assess whether this is a good allocation of funds or to decide how to spend new aid money requires knowing what other donors and aid agencies are spending their money on and to be able to relate those external resources to the Afghan government's own expenditure.

11. Greater aid transparency has significant benefits: more effective **allocation and management** of aid, better recipient government **planning**, increased **accountability** of donors and governments in the North and South, reduced risk of **corruption** and enhanced public **participation**. These factors are essential foundations for meaningful analysis of the impact of ODA and ultimately for generating sustainable economic growth.

12. Progress on aid transparency can occur swiftly and help achieve significant impacts by 2015. The information already exists: now it is a matter of agreeing basic **common standards** around transparency and for all aid actors to move quickly towards proactively publishing what they fund.

Rachel Rank
Research and Monitoring Manager

27 June 2011

Mr Roger Riddell and Professor Aiden Wood—Oral evidence (QQ 1-30)

Evidence Session No.1. *Heard in Public.* *Questions 1 - 30*

TUESDAY 21 JUNE 2011

Members present

Lord Best (Chairman)
Lord Hollick
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witnesses

Professor Adrian Wood [University of Oxford] and **Mr Roger Riddell**, [author of *Does Foreign Aid Really Work?*].

Q252 The Chairman: Welcome, Mr Riddell and Professor Wood. Thank you very much for joining us. I am Richard Best and today I take the chair in the absence of Lord MacGregor. A debate going on downstairs seems to have taken from us an awful lot of our Members, but we still have a very good turnout. We are very glad to see you with us. If when Members speak they have an interest they will declare it before asking you a question. We would be very grateful if you could speak loud and clear, because we record things here and that is helpful to our shorthand writer. The questions that we are going to ask go to both of you, but if you agree with whoever has spoken first please pass on that so we can get through it on time. Would either or both of you like to make an opening statement of any kind, or would you prefer us to go straight into questions?

Professor Wood: I am happy to let you go straight into questions. I do not know what Roger feels.

Roger Riddell: That is fine by me.

Q253 The Chairman: I will go first and ask you what conclusions can be drawn from research on the impact of development aid on a country's economic performance, in particular its economic growth. Are we sure whether or not aid assists economic development?

Professor Wood: There are no really clear and uncontested conclusions on the effects of aid on economic growth. Technically, it is a very difficult area of analysis because so many other things are influencing growth rates in developing countries. The data are not very good; it is very difficult to disentangle the effects of aid. The one thing we can be clear about in the evidence is that almost certainly aid does not reduce growth; there is no strong evidence of it having an adverse effect on average. On average, it looks as though probably aid increases growth. The best estimate is that a 10 percentage point rise in the share of aid in a country's GDP would add between one and two percentage points to its growth rate, but there is a very wide confidence interval around that estimate. It is highly disputed; some people would say there is no significant effect. That is the way I read the evidence.

Roger Riddell: I largely concur with that. To add a few points, it is my view that totting up the number of investigations and what they conclude suggests that most cross-country studies have confirmed the results of earlier studies, which is that aid has tended to contribute to overall growth. The most recent study was done by Professor Tarp of UNU-WIDER, Finland, in which he addressed some of the uncertainties of particularly a key IMF study done in 2006. But I think there is also growing recognition, as Professor Wood says, that the contribution of aid to growth is probably much smaller than people had previously anticipated.

A couple of other things have come out more recently. One is that studies have confirmed, as one would expect, that the contribution aid makes to growth differs sharply in countries at peace and countries in conflict. In addition to the influence of policies on growth, institutions are a critical factor, as are the ownership and commitment of recipients to policies, and also honouring the commitments to provide aid. Aid volatility and its unpredictability has a profound impact on its effects.

The last point I would make is that we have seen a new kind of study coming up done by Professor Mark McGillivray of Australia. He has looked at the effects of aid on different income groups within recipient countries. His broad conclusion is that overall there is a positive relationship between aid and the income of high, middle and lower income groups. However, the larger effect is on middle and higher income groups, and his predictions are that, with the doubling of aid, it is the middle-income group that will benefit the most from an increase in aid.

Q254 The Chairman: You said there was a marked contrast between countries at peace and countries in a state of conflict, by which you mean that the money does a lot better in those places that are peaceful, even though I see in our list that it is the fragile economies and post-conflict countries that will get the majority of our aid. The targeting there would seem to be upside down if the money goes furthest and does the most good in countries at peace.

Roger Riddell: It goes the furthest and does the most good in terms of economic growth, but one should recognise that the evidence that aid can improve social indicators—education and health—is much clearer, and there is some reason to believe that the pay-off is not so different between conflict-afflicted countries and non-conflict-afflicted countries, except that obviously it is more difficult to deliver.

The Chairman: That is very helpful.

Q255 Lord Moonie: How serious are the concerns about the so-called Dutch disease effects of aid? Do large aid inflows tax private sector exports, investment growth, etc?

Professor Wood: I think the concerns are overstated because the analysis is often a bit confused. One needs to distinguish two quite different levels. One is: what are the effects of aid on the structure of the economy? The other is: do those effects on the economic structure have bad long-run effects on growth? These two levels tend to get conflated. Let me separate them out a bit.

The simplest analysis of what we might call the Dutch effect rather than Dutch disease is that a big inflow of aid, or any other kind of foreign exchange, will drive up the real exchange rate and send a signal to consumers and producers in your country that they should be producing fewer exports and import substitutes, so that the production of tradable goods should shrink. That is absolutely natural and sensible because the aid is replacing the need to produce tradable goods. Indeed, if the production of tradable goods did not shrink you would not be able to use the aid. That shift in the structure is perfectly logical, and I do not think anybody disagrees with that.

The issue is whether having a smaller tradable sector in the long run makes you grow slower. People have very divided views on that and there is remarkably little evidence relative to the number of concerns expressed about it. I am aware of only one study, by Dani Rodrik, that has tried systematically to show that having an overvalued exchange rate slows your growth in the long run, mainly by making your manufacturing sector smaller, but I do not think this is anything like as serious a problem as is usually argued. The main macro-problems of aid are the ones Roger was talking about, which are to do with the management problems of very volatile aid flows. That is a nightmare for a chancellor.

Roger Riddell: I do not have much to add except to refer you to what I understand is the most recent study of that by Tony Killick and Mick Foster a few years back, which looked at the effects of Dutch disease in a series of African countries. They could find no evidence. But in two countries, Tanzania and Ghana, they found evidence of private investment being crowded out by aid-related investment. One of the reasons for lack of evidence of Dutch disease was that they found that on the whole countries were accumulating large foreign exchange reserves rather than spending them, which might have led to the adverse effects on the exchange rate. One of the critical studies in relation to how Governments can and have looked at them is by Chris Adams and David Bevan, which suggests that there is a whole range of things governments can do to address particularly the supply side constraints. I would agree with Professor Wood that, looking at the long-term dynamic, the picture is not so bleak.

To sum up, it is a problem but two things seem to be critical. The first is for recipients to be aware of the potential problem, understand how it could occur and take steps to mitigate those effects. The second is a message for donors. They have a key role to play by providing aid in a predictable manner, as short-term volatile inflows can be potentially the most disruptive.

Q256 The Chairman: Has the fact that people have been pursuing the Millennium Development Goals made the position better or worse in relation to the problems of Dutch disease?

Professor Wood: I do not think it has made a great deal of difference, except insofar as it has increased the amount of aid. Insofar as issues are associated with larger amounts of aid, then maybe it has made the issue a bigger one. Would you agree?

Roger Riddell: I do not think it has.

Professor Wood: No; it is not particularly related.

The Chairman: No, it has not made any difference there.

Q257 Lord Hollick: A number of commentators have suggested that aid as measured as a percentage of GNP, or something like that, should be kept at a certain level in order to minimise the impact of the Dutch effect. Do you agree that there is merit in looking at a targeted level of aid as a percentage of GNP in order to minimise the disruptive effects of large inflows?

Professor Wood: The circumstances of individual countries vary so much that I would be cautious about a one-size-fits-all prescription. You can argue that there is an optimal level of aid for each country, and you would arrive at a view on that by considering a wide range of issues to do with the ability of the country to absorb aid and its potential benefits, but you would not target just the aspect of Dutch disease. I think the optimal level would vary a lot depending on which country you are looking at.

Q258 Lord Hollick: Perhaps I may move to the next question. There is a lot of published work about the impact of aid on economic and political governance, much of it drawing rather negative conclusions. Based on your own reading of the evidence, what are the robust lessons that we can draw?

Roger Riddell: One needs to understand the context in which this question is asked. We have moved from a situation where aid was for many years provided predominantly in project form to aid in programme form. The new aid modalities are predominantly sector and budget support. Positively, I think the evidence suggests that there has been a relationship not easily drawn between aid provided in those areas and at least as positive outcomes as one had with project aid. One of the merits of the new aid modalities is that donors are addressing a key issue of fundamental importance to aid, which is institutional development, and trying to move countries to be no longer dependent on aid.

I would agree broadly, however, that much of the literature on donor activity in the sphere of economic and political governance draws negative conclusions. I would highlight five lessons from what we have here. First, ironically, notwithstanding the huge literature on looking at the impact particularly of governance programmes, evaluation is quite poor and there is a lack of hard and fast evidence to show the impact particularly overall of political governance programmes. I think part of the problem lies in the fact that there has been a huge number of very different interventions by different donors and there is a very muddled effect. I think that donors, led in part by DfID, are now looking at governance as a whole and trying to tease out which particular aspects are more important for particular countries and which are not, and I see advances being made in that way.

The second lesson I draw is that donors have wrongly tried to apply a technical template to an issue that has political dimensions. DfID has again led on some very interesting work, particularly with Sweden, on issues to do with political economy and drivers of change. There are many reasons why things have not worked as they should have done and it is essential, as DfID realised many years ago, to look at the political dimensions of that. Where I would argue work needs to be done is in employing more local political analysts. DfID and others tend to bring in people from outside, which is fine and good, but their analysis often needs to be complemented by analysis from those in the country. It is very easy for outsiders to say that these institutions do not work; it is far harder for outsiders to understand why institutions work the way they do in those countries if one wants to change them.

Third, I think donors have looked too much at the supply side and not sufficiently at the demand side of governance. They need to look at what is happening in the country. That will provide them with more room for manoeuvre.

The last point is that the timeframe has been rather too optimistic. These issues will take some time to resolve. Providing sustainable capacity development and substantial institutional change is a long-term process. It takes longer than the length of time that a DfID staff member is in country; it often takes longer than the length of a country programme strategy. This needs to be managed carefully, and I think that is also an important point. I am optimistic that things can improve; I can see evidence of things improving, but it is important for DfID to engage with other donors to address those issues more substantially and holistically.

Professor Wood: That is a really excellent summary of the evidence about aid that has sought to improve governance. I agree with everything Roger has said. If I may add to the analysis one slightly different strand, what have been the effects of aid on governance where the aid is not intended to improve governance? What has aid in general done to governance? I think there is a serious concern here. It is one of my biggest single worries about aid. If you give a country too much aid for too long you damage its basic governance structure because the politicians pay more attention to the donors than they do to their citizens. That has been a serious problem in some countries. It is my main worry about trying to deliver large amounts of aid in the long run in a not very thoughtful way in terms of the implications for governance.

Q259 Lord Hollick: But do not the donor countries make things more difficult by each having their own programmes rather than having co-ordinated ones, so that the recipient country has to manage 10, 20 or 30 programme donors?

Professor Wood: I think that is true across the board, whether you are talking about aid to improve governance or aid to improve the dairy sector. The fragmentation of donor aid has been very costly to recipient countries.

Roger Riddell: It has got worse in the last 10 years. There has been a trebling of the number of projects, and the number of donors that each recipient has to deal with has gone up from about 10 in the 1970s to, at worst, about 35 to 40. The case widely quoted is the Government of Vietnam, which had to receive a donor delegation more than every working day of the year.

The Chairman: My goodness, fragmentation indeed.

Q260 Lord Lipsey: Turning to the UK, it is clear that the level of aid will be a much more controversial topic in that the Government have committed themselves to giving it a very high priority in public expenditure. That is not popular with all Members, particularly those of the governing party. In those circumstances, it is very important that DfID is able to show that its aid policy is evidence based and is achieving the objectives that DfID sets itself. To what extent do you think it is taking into account all the research in proving that? To what extent is our aid policy shaped, or perhaps even distorted, by for example foreign policy considerations that are nothing to do with development considerations?

Roger Riddell: On the last point first, the first decade of this century has seen aid expanding at about 8% a year, which, since aid began in the 1940s, is the decade of the most significant expansion of aid. I think people would agree that one of the factors is the commitment to the millennium development goals, although there have been differing commitments by different donors. Some have agreed for the MDGs to shape their aid programmes, the UK being one; another collection of donors has agreed that the MDGs should inform the allocation of aid; but there is a significant group of donors, including the United States and Japan, for whom the MDGs have made no difference at all to the way they have allocated aid. You will recall that at the time of the Millennium Summit those two donors alone accounted for 40% of all aid.

At the same time, we have had growing concerns in all donor countries about global security issues. That has had a marked effect on the allocation of aid. If you take Pakistan, Iraq and Afghanistan, in 1999 they accounted for less than 1% of total official aid; five years later they accounted for 25% of all official aid. Therefore, a lot of the increase in aid has been influenced by short-term political and strategic interests. That remains true. There is only one out of the 19 major OECD DAC donors, Ireland, for whom those countries are not in the top 10. All the others have in their top 10 recipients those three countries, and, with the exception of the UK providing aid to Pakistan, none of them were before.

Professor Wood: I defer to Roger. I am an insider in the sense that I was DfID's chief economist for five years. I have a biased view on this, so I have declared my interest before I speak. I think DfID for a long period of time has paid an awful lot of attention to evidence. DfID is regarded as the world's best bilateral aid agency, partly because of the fact that it is extremely well staffed with professionals. It has a large number of economists and governance, social development and natural resource advisers. One of the jobs of these groups of people is basically to stay in touch with the evidence and make sure that it is translated into action. It is a very effective system. My job as chief economist was basically to make sure that the economist cadre was kept well informed of what was going on in research and evidence generation outside DfID and that it was appropriately positioned within DfID to influence what it was doing, and there was a set of other heads of profession and chief advisers who did the same thing. I think DfID is a very effective machine for doing this. In addition to the cadres of professional advisers, you now have a policy and evidence division. I wanted that to be called the knowledge intermediation division (but the director general would not have those words on his business card), because basically they are in the business of vacuuming up knowledge from the rest of the world and converting it into forms that make it useful for DfID's operations. I think DfID is highly effective at this.

Q261 Lord Smith of Clifton: Mr Riddell said that there had been significant growth in Afghanistan, Iraq and Pakistan. He did not go on to draw any implications from that. To go back to your earlier answers, it would seem that in terms of the effectiveness of aid that tremendous acceleration was not necessarily the best way of giving them money.

Roger Riddell: I make two points. The first is that it is also true that, if you look at the types of destinations of the expanded aid, there has been a marked increase in aid to education and health. There has been almost a doubling in real terms over a five-year period. Interestingly, however, if you look at the OECD DAC statistics on aid commitments a rather different picture emerges. In the period when the MDGs have been with us, the proportion of total aid commitments to economic infrastructure and direct production has gone up, but at the same time as spending on education and health in real terms. There has been an overall expansion.

In terms of the lessons learnt, as a DfID outsider it might make the session slightly more interesting if I express my first slight difference of opinion with Professor Wood. A few years ago I led a piece of work for IACDI, the Independent Advisory Committee on Development Impact, which has now been laid to rest but out of whose ashes has emerged the Independent Commission for Aid Impact. I led that study looking at the quality of DfID evaluations. Part of the umbrella of quality is the extent to which DfID made use of the evaluation evidence that was coming up. We found that, regrettably, there was a gap between what DfID was learning from the evaluations and follow-through in terms of learning the lessons and feeding it back through policy into action. That was largely because on our analysis there was a rather defensive attitude to evaluation, and managers were keener to defend what they had done rather than be hungry to understand precisely how things could improve in the future. I have a concern in relation to that. Another thing we found was that there was not sufficient linkage between research and evaluation. We felt that managers were not sufficiently on top of all the knowledge that was in the agency to inform the decisions they were making.

Things have moved on since then. I am not directly involved with DfID, but I am assured that things have got better. But I do have three concerns about whether lessons are being or will be learnt. The first relates to the new independent commission of which I am wholeheartedly in favour. My concern is that one of the outcomes of outsourcing evaluation to a body outside an agency is that you risk losing the institutional linkage between policymaking and lesson learning. I have no doubt that, when the commission publishes massive evaluations and they receive a lot of publicity and comments, DfID will certainly deal with the big issues. But there are many smaller issues in evaluation, and I fear that if publicity is not given to them there is a risk that those lessons will be lost.

Second, DfID seems to make some decisions on the allocation of significant amounts of aid that are not based very clearly on its knowledge and expertise. Only last week, in the report of a House of Commons Select Committee in relation to India, the future of DfID's proposed programme in India through the private sector was criticised because "DfID does not have the right private sector expertise in-house".

Third, there is overwhelming evidence that the impact of aid provided by one donor is critically dependent on the policies, behaviour and practices of other donors. I will leave a table that I have produced for the Committee, which shows that out of the top 10 recipients of British bilateral aid the UK provides on average less than 15% of the total aid received by those countries. Therefore, even where you get the largest amounts of British aid, the share of British aid in the total is very small. It seems to me extremely important that DfID should learn the lessons not only of its own experience but that of other donors, and the Paris Declaration, of which DfID is a signatory and to which it is committed, highlights that. What I worry about is that the new policy, the future of UK aid, barely makes any mention of the international dimension and other donors when it talks about aid effectiveness. I fear that is a serious gap in the policy.

The Chairman: That is very helpful.

Q262 Lord Tugendhat: Perhaps I may approach the question of aid as a proportion of the whole, and British aid as a proportion of total aid, from a different point of view. I have in front of me the top 10 recipients of British aid in 2009 and the projection to 2015. All bar one of these countries is very poor and have varied economic success, but the one that stands out is India. After all, India has a very rapid rate of growth and is a very complex country. Aid must be a very small proportion of the Indian economy, and British aid must be a minute proportion of the Indian economy. Apart from the fact that I find it difficult to understand why we should be aiding a country that is growing so rapidly and can afford a space programme, aid programme, nuclear programme and everything, what on earth is the point of being a minute contributor to this dynamic economy that would get on perfectly well without us?

Professor Wood: India does indeed have a space programme and a nuclear one. It has that because it is an absolutely vast country with a huge population. What you need to have a space programme is a critical mass of engineers, which you can have if you are a very big country. China has the same thing. India is also a very rapidly growing country but it is extremely poor. On average, per capita incomes in India are still very low and about 300 million people still live on less than $1.25 a day. The case for giving aid to India is simply to do with the very large numbers of poor people. The issue of whether aid in general, or British aid, can be effective really depends on whether aid is being appropriately targeted on poor groups within the country. That is what donors have been doing in India. They have been targeting aid on states within India that contain large numbers of poor people and that in addition show some capacity to be able to spend the money effectively. I think the contribution of aid to improving, for example, primary school enrolment in poor areas of India has been quite significant. It has been one of the areas where aid has been spent effectively.

Roger Riddell: You raise a really important issue. The question it raises, to which we may well return, is: what is the basis for the allocation of aid? Historically, Britain in common with other donors has based the allocation of aid on poor countries. A recent study by the Institute of Development Studies suggests that over the past few years we have moved from a situation where most of the poorest people live in the poorest countries to one where most of the poorest people now live in middle-income countries, partly because the definition of what a middle-income country is has changed. As Professor Wood indicates, I think I am right in saying that there are more people living in extreme poverty in India than there are in the whole of sub-Saharan Africa, or that was true until at least a few years ago.

Professor Wood: It is very similar in magnitude.

Roger Riddell: That raises a question as to how aid should be allocated. But it raises another question, which I think is what you are referring to. If you have a middle-income country that clearly can afford to do the things that aid is doing—indeed, the figures suggest that British aid as a proportion of gross national income is so minimal it is off the screen—but you decide that a country with poor people merits consideration, then you need to ask: how precisely should the interaction between the donor and the recipient perhaps differ in the middle-income country from in a poor country where the basic problem is a total lack of resources? If you compare India and Bangladesh, India's per capita income is double that of Bangladesh, but Bangladesh scores better on almost all the social indicators. Why is that? It is because of decisions made centrally and by state governments about the proportion of resources that goes into education and health; it is the way that minorities and marginal groups are treated. My view is that Britain is uniquely placed because of its history with India to influence these issues through awareness raising and supporting groups in India—parliamentarians and other groups—and to lobby and campaign and give more power to those kinds of groups that can move India in terms of its social spending more towards the Bangladesh situation. A question that should not be left unexamined is: should you assist countries with significant numbers of poor people? If so, should the approach be the same in those countries as in the poorest countries? I think there are some arguments to suggest that it should differ.

Q263 Lord Tugendhat: To press you one step further, in the nature of things an aid programme has to be justified to the British electorate. That is particularly the case when other programmes are being cut and the aid programme is being privileged in the way that it is. It seems to me that British public opinion, whose support is essential to this enterprise, can understand the justification for giving aid to poor countries that have poor people and do not themselves have the means to elevate the standard of living and the life chances and all the rest of it of those people. They find it harder to understand giving aid to a country that, because it has a space programme, an aid programme, a nuclear programme and all the rest of it, could certainly dispose of its own resources in a different way and benefit the people that our aid is supposed to be benefiting. Is it not the case that by aiding a country like India we are jeopardising popular support for aiding countries that cannot help themselves so much?

Roger Riddell: I think that is a risk, and DfID and other departments that are using aid money for India have an obligation to explain to the British people how the additional amount of aid that Britain has provided is making a tangible difference. If they cannot do that then I think your argument becomes more persuasive. As you know, DfID is dealing with just a few states rather than the national Government. They can look at the programme and show ways in which British aid is making a tangible difference to the poorest people. For instance, as the Select Committee indicated there is plenty of further scope for DfID to work to bring the Dalits and other marginalised groups into the mainstream. There have been some successes there. I think a doubling of aid in that area would have a profound and tangible effect that could be shown to the British people. I am not saying it is easy. You highlight quite correctly that there is a huge problem in perception and in reality, but I think there are ways and ways, and certainly DfID understands the situation very well, and a new and very good programme director has been appointed in India.

The Chairman: That is an important issue, but I think we will have to move at a slightly faster pace to get through all of our questions.

Q264 Lord Shipley: So far we have talked largely about the allocation of aid with the presumption that we have it. I would like to go back to that and ask you both why you think the UK has an aid budget. Why should we have an aid budget?

Professor Wood: I think the central argument that is now made is that there is a moral duty to help our fellow citizens on the planet who are very much poorer than we are and whose situation might be improved by giving them some money. It is the same argument for using public money to assist any group that is disadvantaged or poor, whether they are within or outside our national borders. I think that is the fundamental justification. All kinds of other arguments can be advanced for the UK having an aid budget, including promoting Britain's own national interests, but my own view is that fundamentally the central argument is a moral one.

Q265 Lord Shipley: Is that consistent with the growth agenda?

Professor Wood: With the growth agenda in these countries?

Lord Shipley: Yes.

Professor Wood: Absolutely. In most poor countries you are dealing with mass poverty. The only way you will eliminate mass poverty in the long run is for those countries to grow faster. It is a slightly different story where you are dealing with, say, an upper middle-income country like Brazil that has fairly small pockets of poverty, and there the need is to target those pockets specifically. But for Bangladesh, India and most of Africa, the long-run poverty reduction agenda is a growth agenda.

Q266 Lord Shipley: Mr Riddell, would you support the moral case as being the absolute key principle in driving our allocation of aid?

Professor Wood: It is for me, and I believe that is and has been the view of the Government for a decade and a half.

Q267 Lord Shipley: Mr Riddell, is that your view as well?

Roger Riddell: Yes, almost. In terms of the moral case, I think that is the fundamental factor that drives why the UK has an aid programme: because of moral outrage among British people that there can be people on this planet still living in such an appalling situations of absolute poverty, and the number of deaths from poverty are astronomical—far, far higher than the number dying in emergencies and disasters every year. It needs to be said that Britain is not unique in relation to this. I did a study of international aid a year or two back. The only country I could find that did not have a strong moral basis for its aid programme was Japan. The United States certainly did. It was particularly strong in humanitarian aid, but you can trace it back also in relation to development aid. Another important factor here is that some of the perceptions of the public about the British aid programme show woeful ignorance about the volume of aid that is provided. A study was done recently in Britain mirroring studies done in successive decades in the United States. It asked people how much aid they thought Britain provided to developing countries. Figures not far distant from 10% of government spending were given. When people were told that it was less than 0.7% the most common reaction was one of outrage. How could it be that we are providing so little money to developing countries? Those kinds of views and misconceptions about aid have been dominant in earlier studies in the United States. I think the moral basis for aid is a universal underpinning that drives all.

I do not see that as being incompatible with the provision of development aid and giving people a higher standard of living, which probably helps to make the planet safer, and that is in our interest as well as in the interest of those who are developed. I see it as a subsidiary argument but as a not inconsequential argument.

Q268 Lord Shipley: Are there any limits to the moral case? Logically, we should try to spend more than 0.7%. How should politicians define the moral case?

Professor Wood: My guess is that there is not a limit to the moral case of a moral kind. The key issue is: do you rate the welfare of somebody anywhere in the world the same as you would the welfare of somebody in Britain? Should you care less about a poor person in Bangladesh? I think the logic of the moral case is that we are going to treat everybody on the planet as our fellow human beings; we are going to treat them all the same. I think the limit you hit long before you get anywhere near the moral limit is the practical one. My feeling is that either the UK or the OECD countries collectively could not deliver the implied volumes of aid that would be needed to approach the implications of what you ought to do if you took the moral case to its limit.

Q269 Lord Smith of Clifton: On trade policy, would the resources currently devoted to aid have a greater impact on growth and poverty reduction in recipient countries if they were used instead to finance preferential access to export markets in the OECD?

Professor Wood: Trade is one of the things on which I work. My comment is that it is not entirely clear how you would use aid resources to improve market access. The one thing for which you could conceivably use them is to compensate losers in OECD countries: groups hurt by expansion of imports from developing countries, say garment workers or some categories of farmers. On the whole, with the exception of the need to compensate losers, improving preferential access has not required financial resources; it has required Governments to make political commitments, as in the European Union with the Everything but Arms agreement and in the US with AGOA (the African Growth and Opportunity Act). Improved preferential access is good. I do not think it requires financial resources.

The main constraints to expanding exports from poor countries are on the supply side and not the demand side. There is a section of the aid programme called Aid for Trade, where the focus is to try to relax the supply-side constraints, either production or transport infrastructure. It is a very worthwhile agenda but I do not see much of a trade-off between the two.

Q270 Lord Tugendhat: The millennium development goals are obviously very ambitious and each taken individually is a desirable objective, but do you think that they have facilitated the efficient allocation of aid, or have they put the attempt to resolve current deprivation ahead of the possibility of securing greater growth for the future?

Roger Riddell: If you look at the history of the allocation of aid, even before the Millennium Development Goals were on the table there was an acute mismatch between where aid was going and the poorest countries. The figures suggest that well over a third of all ODA has gone to countries other than the 65 poorest countries, and the reasons for that relate to other influences: commercial, short-term political and strategic interests. Even before we had the Millennium Development Goals the allocation raised questions about its relevance and appropriateness. As we discussed earlier this afternoon, in the decade when we have had the millennium development goals in operation we have seen a massive expansion of aid. Certainly, many donors, particularly northern European ones—I count the UK among them—have given priority to education and social sector spending: water and sanitation. People have said that one of the problems is that it is all well and good to provide short-term aid to meet immediate needs but it is not sufficient to address wealth creation direct, which is why many donors now—the French were in the lead on this—talk about economic infrastructure and production.

There is a fine balance between one and the two, because education is crucial for the development of skills, and, in a world that is globalising, an economy will not have a comparative advantage unless it has a skilled labour force. Therefore, there is merit in providing quality primary education but also a need to go beyond. The MDGs focused only on primary education. If you talk to Ministers of Education in developing countries, there is a crying need for secondary and tertiary education as well. The millennium goals have served a hugely important political purpose in focusing the minds of politicians and the public on the huge gap between what is needed and what can be provided. Sadly, there is still a shortfall between the amount of aid promised and the amount that has been given. If I may just take Africa, an additional $18 billion was promised as part of the millennium development goals package, but only 35% of that has been delivered, and 40% of that increase has been delivered by the United Kingdom. For every pound by which the UK has increased its aid, other donors have failed to make their commitments to the extent of £5. If you look at what Britain has done in relation to what others have done, you can see an imbalance.

Professor Wood: I have nothing to add to that.

Q271 The Chairman: That is a shocking statistic. To move to issues about governance, conditionality and capacity, is it possible to increase aid to the neediest countries without lots of problems of corruption and so-called rent-seeking, where companies lobby for a share of the aid spending without providing anything much in return? Can one reconcile those two?

Professor Wood: Corruption and associated problems in the delivery of aid are absolutely inevitable. You want to help poor countries, and the fundamental reason why they are poor is that they have bad Governments. If they had good Governments they would not be poor. You have to accept that if you are to try to deliver aid in a country that has poor governance, in the sense either that the politicians are inappropriately motivated or that the government machinery is incompetent, there will be leakages. It is not just corruption; aid money will be wasted as well. You have to accept that. The poorer the country, the more acute these problems are. It is what I call the catch-22 of aid. Aid is most effective where it is least needed, and vice versa. It is precisely in the fragile states, for example, which desperately need aid, where it is hardest to spend it. One just has to accept that. The idea that in some way you can avoid these problems and have a completely clean aid programme is unrealistic. The catch-22 of aid is very hard to accept, but I think it is a reality that one needs to accept.

Roger Riddell: I would concur absolutely with that. Aid remains, as it always will, a risky business. I have a few more points to make in relation to corruption that I think are important, but I would like to preface them by saying that the question is phrased by suggesting that we will move into an era of continual expansion of aid, understandably because the UK is committed to expanding aid and I have no reason to believe that it will not honour that commitment. I am sure it will. The World Bank did a study that looked at the effect of financial and banking crises on the aid flows of those donors who were affected by it. I will leave this with you. You can see the picture here. For the first two years after the crisis, overall levels of aid continued to increase and then successively fell for a period of up to 10 years afterwards. Given the extent of the financial crisis that we have been going through, it seems likely that these kinds of effects may well impact far greater than they have thus far on the total amounts of aid. The OECD projections of aid for the next three years suggest that there will be an annual increase of 2% compared with 8% in the previous decade, but those projections are based on those who are reporting to them honouring those commitments. That study by the World Bank casts some doubt on whether that is true. Be that as it may, the issue of corruption needs to be addressed whether aid is increasing or remains at roughly the same level.

The second point I make to add to Professor Wood's answer is that corruption in aid is not unique to developing countries. It is a worldwide phenomenon and is also common in rich countries. You remember hurricanes Katrina and Rita in the United States. The US Auditor General examined the way that federal funds had been spent and discovered that up to 15% of all federal aid had been used for corrupt purposes. I think $1.5 billion of US taxpayers' money had not been used for the purpose intended.

Q272 Lord Smith of Clifton: In view of what Professor Wood said, it is something we have to learn to live with but there must be tolerances here. Is 15%, 25% or 5% acceptable? At what point do you cut off aid if so much is being wasted through incompetence or fraud?

Roger Riddell: There are two answers to that. One is to analyse clearly what have been the causes of particular instances of corruption and determine whether they can be addressed or whether aid can be provided in a different form or through a different channel. Only when those two avenues have been exhausted should one then conclude that aid should not be provided. Zimbabwe is a very good example of a Government steeped in corruption and nepotism where the UK and others have found other channels by which to deliver aid, particularly humanitarian aid, so that the people are not suffering.

The third point I make is that some progress has been made in recent years in increasing the transparency of aid relationships, and some opinion surveys suggest that business leaders in Africa have seen a marked fall in their perception of corruption. Equally, it needs to be noted that a range of efforts that donors have embarked on to address the problem of corruption simply have not worked. For instance, the establishment of anti-corruption agencies and getting states to adopt new anti-corruption laws has had very little effect on corruption in developing countries. There are recommendations, which I will not go into here, as to what one should do about it.

To sum up, in my view we should not accept any level of corruption in aid giving, though we should probably expect it. We should work always to reduce corruption. The exposure of corruption should not be used as the sole ground for stopping aid; rather, its cause should be identified and, if necessary, different channels found to provide aid.

The Chairman: Thank you very much for that full answer.

Q273 Lord Moonie: Should the amount of aid given to an individual country be capped to limit the growth-retarding effects associated with extremely high aid flows? I know this is a particular interest of Professor Wood.

Professor Wood: Yes. I made a proposal of this kind. I argued that aid should be capped. My particular worry was the governance issues that I talked about earlier. If you give too much aid to a country for too long a period the Government of the country concerned pays more attention to the donors than to the citizenry. A very simple-minded proposal, which is not what I would literally recommend but focuses the mind, is the idea of limiting aid to any country over the medium term to 50% of what that country raises in tax revenue from its citizens, excluding revenue from things like oil. That ensures that the aid will always be a minority of public revenue, so the Government will always have to pay more attention to its citizens than to donors. That was a very simple proposal.

If one goes beyond that one must recognise that one size does not fit all; one probably wants different percentages for different countries. Where I would like to go from this simple idea is to introduce into the Paris aid agenda much more explicitly the idea of burden sharing. Up to now the levels of aid promised to countries have been unrelated to how much revenue the countries themselves have been raising from their own citizens. I think that any deal that donors strike with a country about aid should have a burden-sharing element. We will contribute this much and they will contribute that much, which should be bigger than what we contribute. That is the kind of approach I would like. It moves beyond the idea of a simple cap but it embodies the spirit of the cap. But the problem with that idea, even in this more general form, is: can one really imagine all the 35 donor agencies that Roger talked about earlier agreeing to such a burden-sharing deal and implementing it? There is a real issue of practicality in that respect.

Roger Riddell: Self-evidently, if you continue to pour aid into an economy a time will come when you reap diminishing returns. No one wants to see that. One of the key questions, therefore, is: when does that occur? Studies have been made of the absorptive capacities of recipient countries, and, in terms of the ODA gross national income ratio, those figures range from a low of about 6% to as much as 60%. The general consensus used to be that at 10% you need to get worried; more recently, people have said that maybe you should get worried at 15%. We need not worry too much about the exact number, but it is instructive to look at the countries to which the UK gives bilateral aid and to ask that question of them. We find that, of the 10 most important countries in receipt of UK aid, only two have a ratio of ODA to gross national income higher than the 15%. Afghanistan is way out. I forget the figure, but it is very high.

One country that has quite a high ratio to which Britain does provide aid is Ethiopia. It also happens to be a country on which the World Bank has done a particular study in terms of its absorptive capacity. It was led by the former chief economist of the bank. The study concluded that, by taking action and addressing a number of bottlenecks, the ratio could be raised from about 15% to about 35% over time. My view is that the issue is important, but in terms of the majority of countries to which the UK gives aid we are probably not at a level where this issue is particularly serious. In terms of the 27 countries to which Britain is talking about providing aid, we will have some problems. One is Somalia; Sierra Leone is potentially another. This is an issue that increasingly will have to be addressed by the UK Government as they move from having a large number of recipients to focusing what is likely to be more aid on a smaller number of countries.

Q274 Lord Hollick: Can the adverse effects of high aid flows be mitigated if the way of aid delivery is altered, for example if we have ring-fenced projects that can be more easily scrutinised and controlled? Should we look to go more in that direction?

Roger Riddell: Generally speaking, I am not in favour of that but there are circumstances where that will be appropriate. There will always be a place for project aid. If you look at how the massive amounts of aid to Afghanistan are distributed, not only are most managed by aid agencies but a significant proportion of development aid is implemented by the military. One way clearly is not to bring aid through government channels but to have it off budget. Another factor is humanitarian aid, which is also provided through different mechanisms from the others. At the margin there are different ways in which you can address the problem, but the Ethiopian study was talking about addressing institutional constraints that prevented the Government from using those funds efficiently, and that is why in a number of countries the foreign aid accumulated in the reserve bank rather than being spent.

Q275 Lord Lipsey: There has been a move in DfID and other donor countries towards micro-conditionality and the imposition of really detailed conditions on the aid that is given according to a broader set of principles. Has that worked, or are we about to see a swing back to where we were before?

Professor Wood: I think one has to look at the change in the mode of conditionality as part of a larger package. Under the Paris agenda there was a move towards what is called the country-led model. That is a model in which you want the recipient country Government to own the development programme and the donors to support it. I think that shift in strategy has been highly effective, certainly in comparison with the structural adjustment model before that, where policies were not owned by the Governments and not implemented and the whole thing turned into a farce. I think this shift has worked well. In a way, it has also worked well by reducing dependence on donor projects, particularly in Africa where the problem was that there were just so many projects that they undermined government capacity. Donors were poaching civil servants to administer their projects. Like Roger, I feel that projects will always have a role but they are not the best mechanisms for delivering very large volumes of aid in countries with low institutional capacity. I do not think we will go back to the kinds of conditionality that we had in structural adjustment programmes. There have always been micro-conditions attached to project loans, which will continue, but on the whole if you see it as part of this package it has helped.

Q276 Lord Shipley: You mentioned earlier absorptive capacity. What do you think the UK Government should do to try to reduce some of the demands placed upon recipient countries?

Roger Riddell: I think the Paris Declaration is a pretty good document in highlighting some of the problems and what should be done to resolve them. First, we have the problem of too many projects, which in some way is being addressed by the new aid modalities and pooling aid together. There are still too many donors in each sector. There is a division of labour initiative taking place that is trying to rationalise that. The UK has been in the lead in West Africa in giving some of its aid to other donors to manage, which is a good example of that. As to donors working together, there is a far greater need to harmonise the different ways that individual donors give aid. There is still a greater need to align the programmes of particular donors more to the policies and strategies of the recipient country; and, as indicated in the question, co-ordination is also important. But, interestingly, the Paris Declaration does not talk about the co-ordination of aid by donors but the co-ordination of aid by the recipient, the thinking behind it being that what donors should be doing is trying to build the capacity of recipients so that, hopefully, in a short period of time it is the recipient who manages the donor relationship and ensures that each donor's comparative advantage is best used to the benefit of the country. As an aside, one of my worries in the approach of the coalition Government in pre-determining that aid from the UK will provide thousands of extra school places for students and provide clean water for *x* number of people is that that kind of decision needs to be based on understanding in country what other donors are doing and where the comparative advantage of the UK lies. Sadly, in some respects Britain is very good compared with other donors in providing aid. Providing bed nets and vaccinations is the easy part of aid. We are very good at it, but we are also much better than other agencies at capacity development, trying to bring the rule of law into countries in reforming the prison service. They are softer but extremely important areas for governance. I worry that pre-determining lists of what Britain will do may well not be in each particular country the kind of aid where Britain can make a real difference to enable those countries to create a self-sustaining development programme.

Q277 The Chairman: I get the impression that both of you are saying that the UK is especially good at aid in terms of international comparison. We may have some bias here. Are you telling us that, in the great scheme of things, our capacity to do the right thing is something of which we should be very proud?

Roger Riddell: I indicated earlier that I did a study for DfID as part of the IACDI group. Richard Manning, the former head of the Development Assistance Committee, was one of the consultants who did that study with us. He spoke to bilateral and multilateral agencies and it was a study of the quality of DfID's evaluation. You can read his study; it is on the website. He came to the conclusion that the way Britain evaluated aid was among the best in the world.

Q278 Lord Smith of Clifton: This brings us very much to the future shape and pattern of OECD aid given its relative decline in view of the more private inflows of investment, remittances and so on. How do you see the future of the OECD? Will it be concentrating more on issues like prison policy and things like that, or what?

Roger Riddell: If you look at trends in ODA and private flows, over the last 25 years the latter have swamped the former and are now valued at two or three times as much. If you look at developing countries as a whole, they benefit far more from private overseas investment—financial investment at commercial rates—than they do from ODA. If, however, you look at the poorest countries you see a very different picture. Consistently, from the 1980s right up to the present day, well over 90% of all external resources to the poorest countries have remained official development assistance, so the overall tend of private investment has not sufficiently touched low-income countries. If you look again at the least developed recipient countries to which Britain gives aid, this is true in all cases except one.

The other flow that has been dramatic and has changed in recent years is that of remittances. It was in the mid-1990s that the level of remittances became higher than ODA.

They have also continued to expand and reached about 450 billion in 2008, again about four times as high as overall ODA. People have argued that because of remittances countries do not need ODA. One needs to be a little careful about that. Remittances affect only 3% of the world's population, so although in absolute terms they are important they do not cover everyone. In some countries remittances have been absolutely fundamental to large groups of people, Zimbabwe being a very good example in relation to that. Studies examining the effect of remittances on poor people have, perhaps understandably, provided different evidence. Some have suggested that the impact on the poor is positive; some have suggested that the poor have not benefited greatly. Aggregate data suggest that most remittances are channelled to the middle class and wealthy individuals in high per capita income countries. Today, only 6% of remittances flow to people in the least developed countries, so, rather like private investment, one needs to understand the very marked differences in the benefits of these to different groups of people.

My view is that, in terms of OECD countries as a whole, one is likely to see the influence of particularly private investment flows perhaps in shaping the allocation and reducing the amount of aid money that goes to middle-income countries and perhaps increasing the amount that goes to poor countries. But one faces Professor Wood's catch-22 dilemma that the public is also interested in impact. The more money you provide to those countries where the risk of it not being used effectively increases, then you have a problem. You always have to juggle the two factors of wanting aid to achieve maximum impact and wanting it to reach those in need, and there is no simple answer to that.

Q279 Lord Tugendhat: You said earlier that you thought Britain was rather good at aid, and that is gratifying to hear. I understand that the aid budget has increased by 47% from 2005-06 to 2009-10, and over the same period the administration budget has remained constant and accounts for 3.5% of the total DfID spend. Do you think DfID has the capacity to deal with a rapidly expanding aid budget, given that a small proportion is devoted to administration?

Professor Wood: I have very serious concerns about this. This was a strategy embarked on by the previous Government of greatly expanding the DfID programme budget while making a reduction in the number of staff across all Whitehall departments, so the amount of aid spend per staff member will go up dramatically. To put it the other way round, there will be fewer and fewer people per $1 million of aid spent. I think that was a serious strategic mistake and is made worse by the bilateral aid review concentrating more of DfID's aid in future on more difficult environments in which to work. To deliver aid effectively, particularly in fragile states, is a very labour-intensive activity. I am seriously concerned that there is a mismatch here. I do not think that the suggested solution, which is that more of the aid budget should be spent by other Whitehall departments, is a proper one. I fully accept that the UK Government need to do far more than deliver aid to assist development. There are all kinds of other things you can do, and security concerns and trade issues are very important, but aid is important and other government departments are not technically equipped to deliver aid effectively. This question very much strikes home to me. I do not know what Roger feels about it.

Roger Riddell: I also feel very strongly about it. In the first years of the Blair Government the aid budget began to expand rapidly. In the years from 1999 to 2005 DfID staff increased by 40%. From 2005 to 2008 aid continued to expand at a rapid level and staff levels fell from just fewer than 3,000 to about 2,300. The spending review and DfID's annual report suggest that over the next few years core administration costs will be cut by a further £34 million from £128 million to £94 million. This policy has been criticised by the National Audit Office, the House of Commons IDC Select Committee and twice in the OECD peer reviews of the United Kingdom, first in 2006 and more recently in 2010. The IDC draws attention to the experience of the United States, which did precisely the same thing. It now realises that it made a grave mistake and is in the process of trying to rebuild, at great additional expense to itself, its human capacity to deliver aid.

I see four major problems that will result from the current policy. First, the quality of the aid programme, both bilateral and multilateral, will suffer. Certainly, while closing some offices will mean that staff will no longer be needed in those countries, running larger programmes requires additional staff in a kind of exponential way. I am sure Professor Wood would agree. If you run a bigger programme you do more things; you have to interact with more donors with more recipient departments, and you need proportionally more aid to run those departments efficiently. Technical staff have already been forced to become merely administrators. When you talk to developing country Governments, what they prize most in DfID specialists is the technical advice they have to offer. Even now they are not able to do that.

The second problem is that DfID's wider influence, which we have spoken up and flagged, is likely to suffer as a result of the reduction in numbers, because at the margin DfID staff will have to attend to their own programme and will not have enough time to interact and champion some of the successful changes in aid that we have seen internationally.

Third, DfID risks becoming a poorer learning organisation. One of the ways that DfID has tried to address this problem is to outsource more and more technical issues to consultants. The effect is that it is outsourcing its knowledge so that the knowledge that used to exist in the agency now resides in consultancy companies. That means the ability of DfID to learn and make the right decisions is becoming increasingly difficult.

The fourth and final issue is that staff morale will continue to fall. Already staff morale in DfID is not good. You give people who are already working very hard more and more work. When posts are let go, it is not that the work will not be done; it has to be redistributed to others. The effect of that is that people burn out. Some people, particularly those with long experience in the agency, are likely to leave to be replaced by those who do not have the knowledge, and again the quality of the programme suffers. All in all, I think this is an extremely serious problem that I hope your Committee will talk about vociferously.

Q280 Lord Tugendhat: I very much take the points you have made and I am sympathetic to them. Looking at the figures we have been given and those you have talked about, how does DfID compare with other comparable agencies in comparable countries?

Roger Riddell: The only figures that I have—Adrian may well know of them—are from the study Richard Manning did and relate to the portfolios that evaluation staff had to manage in DfID compared with others. DfID's staff overall had to manage more evaluations than staff in other agencies, accounting for a far higher level of total project funding. The comparison suggested that they were far more responsible and had a higher workload than others. Whether or not that was too much the figures did not tell us, but certainly the comparable figures showed that DfID staff had more work than staff in other agencies.

Professor Wood: You can find that information up to a point by going to the DAC statistics. The problem in making a fair comparison is that DfID is unusual in having a single aid agency, whereas in other countries—the US, France and so on—this is broken up among different government departments. It is hard to say that in other countries this number of people work in the development assistance agency, but you could make a lot of headway by looking at the DAC numbers. I am sorry I have not done the calculation, but there are enough data to be able to make some headway on this.

Q281 The Chairman: In the calculation of the 0.7% of overall spending, are we putting in the 3.5% admin charge, or are we counting it separately? If it is included, politically the decision then is how much one should spend on administration without worrying about the total cost to the taxpayer, because the ceiling is then applied that would incorporate it.

Professor Wood: My understanding is that it is in there; it is absolutely a political decision about how one allocates the total amount of money between cash going to the countries and staff. For reasons that are beyond my comprehension, these two decisions have somehow become completely de-linked.

The Chairman: For us it is an important issue on which to conclude. On behalf of all of us, thank you very much indeed. You are our first two witnesses, so it has been very important for us to get our heads round all of this. I do not think we could have done better than to hear from both of you. Thank you very much indeed for your time and input.

Professor Wood: Thank you for giving us the opportunity to contribute.

Roger Riddell: Thank you for inviting us.

Professor Jeffrey Sachs, Columbia University—Oral evidence (QQ 460-479)

Evidence Session No. 13. *Heard in Public.* *Questions 460 - 479*

TUESDAY 6 DECEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Lawson of Blaby
Lord Levene of Portsoken
Lord Lipsey
Lord Smith of Clifton
Lord Shipley
Lord Tugendhat

Examination of Witness

Professor Jeffrey Sachs, Director, Earth Institute, Columbia University

Q460 The Chairman: Professor Sachs, good afternoon. This is the 12th public hearing of our inquiry into the impact and effectiveness of development aid. Welcome and thank you very much indeed for coming. We realise that you have a very busy schedule. You obviously have a big reputation in this area, so we are very grateful to you for coming to our hearing. For these sorts of hearings, perhaps you would speak loud and clear for the benefit of the webcast and the shorthand writers who are taking this all down.

Perhaps I can start by asking this question: in your book, *The End of Poverty*, and in your work with the UN Millennium Project, you argue strongly that aid can and should play a central role in lifting the poorest people and the poorest countries out of poverty. As you know, we are looking specifically at the impact and effectiveness of aid. I wonder whether you would begin by indicating the evidence, as you see it, for the good effect of aid.

Professor Sachs: Thank you very much. I am very honoured to be here. Call any time. What you are doing in this Committee and what the United Kingdom is doing is most impressive and inspiring. The fact that in a difficult economic environment the UK is pushing ahead across parties to fulfil an international goal of 0.7% has, I would say, riveted the world. It has attracted enormous positive attention and I believe it will benefit the world and this country for many years to come. I am really grateful for the commitment of this country and also grateful for your inquiry and the chance to be part of it.

My argument about development assistance is that if it is focused, practical, measurable and monitored, we have a vast experience of success. I could give an example in which the UK is playing a leadership role and that's GAVI. GAVI is introducing and scaling up access to vaccines. Vaccines are among the most powerful and cost-effective technologies we have to address disease burdens in the world and especially the unmet disease challenges in poor countries. Whenever we have had a focused, sustained, development programme worldwide to expand the coverage of vaccines, the pay-off has been tremendous in two senses. One in the sense that it actually works and coverage goes up and disease burden comes down. This already happened with UNICEF initiatives in the 1990s, led famously by the head of UNICEF at that time. Now with GAVI there are the positive, powerful results of introducing the new stream of vaccines that have come on line to make them available for poor countries. Once again, we see that not only is the money coming in, but the vaccines are going into the arms of young children to protect them and the burden of disease is coming down.

Another initiative, very close in spirit to GAVI—indeed, it was designed around almost the same time and with the same precepts—is the Global Fund to Fight AIDS, TB and Malaria. Once again, that fund is multilateral and it is committed to delivering measurable, monitored, specific technologies for those three diseases. It has been in existence for 10 years and it has saved, on a highly credible estimate, about 8 million lives directly. I would say that it has protected tens or even hundreds of millions of people from contracting these three diseases, especially malaria, for example, which covers a huge population. We can see, in the most recent estimates, that the malaria burden in sub-Saharan Africa has come down by an estimated 39% from the 2000 baseline to 2010. That is the modelling of the World Health Organisation and what is called Roll Back Malaria, which is the global partnership to implement malaria control.

I was involved with the setting up of the Global Fund and the scaling up of malaria control. Ten years ago, there was huge scepticism: "It will not work, money will go awry, bed nets will be stolen, they won't be used properly." Now we are 10 years into this and we are seeing a dramatic fall of incidence of the disease and deaths from the disease. What makes that possible? The answer is powerful technologies, which are straightforward to implement; and sustained funding that is understood, accountable and monitored, so that when the money is available you know what you are buying, you can check whether it was actually bought and you can stop it if corruption is infecting the system, as it does on occasion. This to my mind is the hallmark of effective development assistance.

At small scale, one can experiment or one can do nice projects which are pleasing and which open the public's eyes to the challenge and so forth, or simply engaging people in the UK or in the US in these efforts, I would not say in a symbolic way but in a way that promotes the human interest, which is very important. Where development assistance is absolutely transformative is when you have a powerful technology appropriate for very poor countries; it is a high priority to implement them; there are delivery mechanisms that are either known or can be developed; you can monitor and put in checks against corruption and mismanagement. The results, whether in disease control, in food supply for smallholder farmer production, children in school or in basic infrastructure, all have the same characteristic, in my view, that they are very practical and they work. This is not to say that aid is effective on average; this is to say that aid *can* be highly effective and highly transformative.

Q461 The Chairman: We have been receiving quite a bit of evidence about corruption and about money being siphoned off through Governments and we have had a lot of discussion about whether it is better delivered through NGOs and other things than through Governments and so on. You are suggesting that the money goes directly. Could you say a little more about how one avoids all the difficulties?

Professor Sachs: Corruption is a pervasive phenomenon in all countries. The way to combat it, aside from proper moral injunctions, which have their role, is through proper information systems, monitoring and evaluation. It is the ability to track money to ultimate purposes and to hold recipients accountable that I think is absolutely the key. This ability has expanded profoundly in the last 10 years because of information systems. Almost any village anywhere in the world now has the internet, mobile phones, text messaging, barcode reading and many other handy things that let us know about the sheer logistics of what is happening.

I am not a great fan of handing money over to Governments. As development aid, or even to my own Government, frankly. I am a big fan of well targeted, well defined programmes that can accomplish well designed and specified purposes. So I am not keen on programmes that say, "You are a good Government, you get high governance scores from the World Bank, therefore you are going to be a recipient of budget assistance and we trust you." I trust nobody. I also believe that handing money over to a Government and expecting it to reach the local level is a hope too far, except if it is very carefully designed. Even a well meaning Government that is not especially competent will not be able to drive it down to the local level. Again, I can speak for my own country: it is very hard to get money to its proper local use unless you have thought hard about the kind of delivery system you have. The more hands it passes through, the more layers of bureaucracy, the more constraints and so forth, it becomes very hard. Delivering bed nets or vaccines has standardised and ever improved mechanisms for global application. I am all in favour of innovation as long as it is very practical and directed innovation.

I do not think that this idea, "We trust you now you are a budget recipient," is a sufficient approach to development aid. It is a very popular one, but I do not believe it, because I do not think that aid is a matter of trust primarily. I think aid is essentially a contract: "We will provide financial assistance and you will fulfil the responsibilities incumbent upon you as recipient to carry out a programmed set of activities." The more we can keep to that and the more we can leave Governments to do the less measurable things on their own—because it's their own responsibility and accountability is very hard, and they have to manage that—the better off we will be in general.

So I see corruption as a very pragmatic challenge. Even in our own projects that we run, we see corruption—petty, and even not intended to be petty, sometimes aiming for something a little larger; it is absolutely possible in any system. The goal is not to say we are corruption free, but to say that we are corruption proof, in the sense that within a month, within a quarter, at most within six months, you know something is not right. And you have the ability to say, "Bed nets cost only $5, so why are the invoices this or why have they not reached local communities?" and spot audits and verification mechanisms are brought into play. In my opinion, this is the way that one ultimately fights the issue, not by classification of countries and essentially saying, "We trust you," or, "We don't trust you."

The NGO issue is quite complicated. While NGOs play an important role, they are not, in my opinion, the ultimate mechanism for success. Consider the NHS, for example. I happen to be a fan of the National Health Service. The National Health Service is not the sum of a large number of NGOs; it is a public effort organised over many decades, always needing reform, updating and so on. It is a coherent national programme. NGOs cannot deliver on that. Going through NGOs for the purpose of making a workaround on Governments, in my opinion, is not going to lead to where we need to go in the end. It will not deliver the systems that are really at the core of a scaled-up approach to health or smallholder farming and so on.

NGOs can play a very important role in showing innovation, in introducing a new technique and in demonstrating the potential of doing something novel and unusual. Indeed, that is probably the only way to do things. However, they are not the approach to working around Government. If Government cannot function, then aid may play a role on a humanitarian basis, but I do not think that it will generally play a role on a systemic basis. In other words, NGOs are not substitutes for Governments, in my opinion.

Q462 Lord Lawson of Blaby: Let me follow on from what you are saying, which is very interesting. You were saying that although most, although not all, of these countries can afford to provide these bed nets and probably most of the vaccines, most of which are fairly basic—they are not brand new and state of the art—they will not do it, and that, unless you have some outside agency with a hands-on approach, it is unlikely to happen. That is where the benefit comes. What you are describing is rather like—I hope that you will not take this amiss—what happened in many parts of the British Empire when the British commissions overseas felt like that they had a moral responsibility to see that the people had this detailed help. It is that sort of thing, rather than what is normally understood by the aid donors, particularly the multilateral aid donors, to be what aid is about.

Professor Sachs: If I may, let me try to be more clear. I want to suggest something a little different from this. I am not especially an advocate of aid for middle-income countries, period. In the last 10 years, even though I am sometimes regarded as quite an extreme proponent of aid, I have spent literally zero time, I think, calling for aid for Brazil, Mexico, Argentina or a middle-income country. My attention is focused entirely on low-income countries, because it is actually this question that you are posing that is the key. I want aid to go to countries that cannot afford to do these things and that therefore need to be helped out of the poverty trap. If they can afford it but they are not doing it, I am perfectly happy to have a conversation with them; I am perfectly happy to make recommendations about why they should be getting better value for their money or why they are making a miserable investment in going for military armaments rather than going for vaccines.

The problem that I am addressing is the problem of low-income countries. I will just give an example. A typical low-income country in sub-Saharan Africa has an income of about $300 to $400 per capita. If such a country is very well run, it might collect revenues in the order of 20% of GDP. So, you might get for Government $60 to $80 per person per year total in a poor sub-Saharan African country. That is a kind of iron law of poverty: you cannot collect more revenues without wrecking the economy and you cannot even perhaps collect that very easily. What you are left with for all functions of government is minuscule by anything that we are familiar with. If you try to allocate $80 per capita among all the roads, the power, the water, the environment, the infrastructure, the courts, the judicial system, the deeds—all the rule-of-law institutions—the education system and the health system, you find out that what you have available for health is maybe 15% of that. Indeed, that is the international norm called the Abuja target—that poor countries should invest 15% of their budget for health. But start with the $400 per capita country, take 20%, which is $80 for all government, and take 15% of that and you have $12 for public health. Our countries are spending $2,500 or $3,000. The United States is spending $8,000—and we are getting about $3,000 of value, by the way. The poorest countries have $12 or $15 of their domestic resources available.

We have calculated this repeatedly. I have been head of two major international studies in the past decade—indeed, we are having a 10th anniversary at Chatham House on Friday of a commission that I chaired for the World Health Organisation on this. Then, for Kofi Annan I also chaired a major study on how much it costs to run even the most rudimentary primary health system. The answer in today's dollars is between $50 and $60 per person per year. You can imagine that you do not get very far on that, but it is surprising how far you can get, because you really can control most infectious diseases, have safe childbirth and deal with most nutritional disorders for $50 to $60 per capita. What is shocking—and it shocks me to my soul, I have to tell you—is that the poorest countries cannot even afford that. So without development aid, even optimally managed impoverished countries, if I can say that, without our help cannot stay alive, literally. That is really my motivation for aid. These countries have so little income of their own that they are trapped in poverty. Even if they know what to do, they cannot do it.

That is why something as simple as provision of bed nets is transformative. Ten years ago I started a campaign to freely distribute bed nets. My partner in this was one of the UK's greatest scientists, the late Professor Chris Curtis at the London School of Hygiene and Tropical Medicine, who was the great pioneer of insecticide-treated bed nets. We published an article nearly a decade ago saying that these have to be given away, because if they are sold, Government cannot pay for it and the poorest people themselves, even to stay alive, cannot pay for it. We went through a kind of proof, because for a long time DfID wanted to sell the nets and USAID wanted to sell the nets, albeit at what was called a socially marketed price. But I was saying, "Zero, please. We can't sell bed nets to poor people. We have to make them available." We went through seven years of trying to cover partial costs. We got up to 3% coverage. In the last three years there has been mass distribution supported by the Global Fund to Fight AIDS, TB and Malaria. About 250 million nets have gone out and we are covering something like 60% of the sleeping sites. We see the disease just plummeting. People are amazed. Now, you have to follow it up or you will lose the benefit of this. There are many more things to do. But the point I am making is that aid is for poor countries; it is not for poorly governed middle-income countries, as far as I can see. If it is a poorly governed middle-income country, we are not going to fix their governance. I have been around that for 30 years. Conditionality does not work.

Q463 Lord Lawson of Blaby: May I ask a question broadening out from that? We have had quite a lot of evidence—I could go into the detail if you like, but I do not think that I need to, because you know the area so well—suggesting that if you look at aid as it is, but not aid as you would perhaps like it to be, there are a number of downsides. Would you agree with that? If so, which downsides would you identify?

Professor Sachs: I think that there is a lot of aid that I would not even put under the aid category, first of all. Let me mention a few things. First, I know the US budget much better than I know the DfID budget, so I will speak about the US just briefly. We give a lot of aid, we call it, to war-zone countries that are US allies as a kind of general budget support. I would count none of that as aid. Very little of it shows up in development. This is political purchase, this is foreign policy, but it is not development. It does not have any of the strictures of development and it does not meet a single criterion that I have suggested in my remarks. It is not tested or vetted. It is a pay-off in some political foreign policy sense—let me put it that way. It does not produce development. It may produce foreign policy results occasionally, although I have my doubts about that also. It generally produces a waste of money, as far as I am concerned. So that is one kind of aid that I do not even count as aid.

Another general misguided approach, which has its merits in the very short term but is the wrong way of looking at this problem, is our food aid. We give a lot of food. This programme started in the United States in the 1960s, when the farm state Senators in the US, and a wonderful farm state Senator, Senator George McGovern, said, "We have surpluses in the US and we have hungry people abroad. This is a great deal." His constituency loved it and the recipients got to have some food, but food aid in my opinion has no place other than direct, immediate, urgent famine relief, and even there with the proviso that a lot of these famines would not be occurring had we been helping agricultural development in the first place. So a lot of what passes for aid is a patch-up because of our failures to focus on the more fundamental issues. That is a second kind of aid that I think is highly problematic. One of the things that we have been pressing in the African context—Africa is a food-deficit, hungry continent—is that without question in a few years Africa could be staple-grain self-sufficient if we just worked at it a little bit. Of course, in the US Congress you can barely get support for this. The farm state Senators know what they are doing and they are interested in food aid from Iowa, which turns out to be about eight times the cost of helping with fertiliser and better seed in situ in a sub-Saharan African smallholder environment. So that is a second kind of wasted aid.

I would say that a third kind of wasted aid is the pure trust, "Make some good use of it, you have a budget deficit" kind of aid. Again, I do not believe in it. Probably I am not supposed to say this, with all my friends in developing country Governments, but the fact of the matter is that, if we are going to do something, I would like it to be incremental, clear, rigorous and accountable. Under those conditions, we are going to get much farther. I am also, by the way, for ending aid through graduation. Aid is not an indefinite, endless injunction; it is in my opinion to help low-income countries in a poverty trap to get out of that trap and to get on to their own self-sustaining growth path. This does not mean that we should end aid now, mind you. I am all for the 0.7%, as I said, because I know from 25 years of my own thinking about this that there are countries that need this to get out of the trap. But it is to say that our goal is really to move to a point where countries can graduate. This does not mean the end of international financing; it just means that we would move to international financing for truly global public goods, whether it is the environment, disease surveillance or other things, but not aid per se. I can absolutely imagine within a reasonable period of time—I would hope 20 years or 25 years at the outside—that this whole effort has been a great success and that that phase of history is over.

Q464 Lord Lawson of Blaby: That would certainly be very nice, but there are some who say that, in a sense, by providing aid as it is given at present, you are delaying that evolution—the politics becomes aid-dependent; political accountability is distorted; aid-receiving Governments seem to think that they have to take more care of the donors than of the needs and feelings of their own people. So you are in fact delaying the happy evolution that you would like to see.

Professor Sachs: I think that that is possible in some cases if all of this is very badly managed. What I do not believe is that there is a way of doing this without the assistance. That compels us to make the assistance effective, not to deny its importance. To my mind, that is absolutely true. Another point about destructive aid is the famous example of Ministers, Prime Ministers and Presidents who have to see hundreds or even thousands of visiting counterpart officials checking on their individual bilateral aid programmes. Programmes like GAVI and the Global Fund are notable not only in being technology-based, monitorable, highly cost-effective and very powerful priorities; they are also effective in that the donors have pooled their money, and so the country has one programme. It does not have 23 programmes for the members of the DAC, and it does not have hundreds of programmes when you add in the others. It has one national malaria control programme financed by a grant from the Global Fund, Anything we can do to simplify the life and make it very practical, it is not a dependency relationship.

I would also agree on another matter now that you have prompted me. Many times we face the problem or reality that a country does not behave the way "we" would like in an election, so we say, "Aid has got to stop. That wasn't done right". Or there might have been a terrible occurrence, and there can be terrible occurrences, such as a denial of human rights or homophobic attitudes in some countries, which provoke the reaction, "We have to suspend aid until country X gets things right." This absolutely can undermine development as well. If one believes that the purpose of aid is to fine-tune the social, political and cultural responses of another country, it is going to be a very disappointing exercise indeed. Aid works when it is really about development. To make aid carry the foreign policy burden, to make aid carry the cultural burden, to make aid carry the political-reform burden, in my view is just mixing instrumentalities.

I am all for diplomacy on many different levels for aid, I believe that it works for one thing: for development assistance. Of course, I am focused on that. But if you want bed nets to cover people who will otherwise die of malaria, that can be done, and it is really important that that be done, not only because it saves lives but because it promotes development. I would like to focus on the things that we really can do. By the way, if that Government mess up, not in a genocidal way but in the sense that we do not like how they ran their primary or something else, we should continue delivering the bed nets. In other words, you cannot fine-tune another country through the modest provision of financing that we make, but what you can do is brake development.

So I think that your point is correct. What I have not been able to discover in 25 years is a way to do without the help. I have found many cases where the help is not really much help, but I have not been able to find the way that this happens on its own so that poor people stay alive and are availed of these basic technologies when they do not have the revenues to stay alive.

Q465 Lord Lipsey: You are making a very interesting point and I just wanted to follow up one implication, because within British aid policy there is an increasing strand devoted to combating the effects of climate change, about which a number of us, for various reasons—not all of us are climate change sceptics—have been sceptical as to whether this is a sensible use of an aid programme. I therefore wonder whether you would like to say in terms what you think of that kind of focus in aid programmes.

Professor Sachs: I am not a climate change sceptic, because I run a development institution with about 500 climatologists and earth scientists who tell me every day, "If you are not terrified by now, you ought to be." I will just pass along that thought from my colleagues, who are some of the world's leading climatologists. We need a global policy regime on climate change. We are not getting it right now. Maybe some miracle will happen in Durban this week. But the whole climate change policy regime has not worked. We are 20 years into the framework convention and we have accomplished almost nothing, I would say. There are many problems on that. To a large extent I would put climate change into its own category. It is a very complex topic. Of course, a lot of it is about energy systems and low-carbon mitigation of greenhouse gas emissions. Where it impacts development, however, should be understood. Anthropogenic climate change I believe to be occurring and I believe it to be having very powerful and dire effects already in fragile ecosystems.

I spent a lot of this past summer around the Horn of Africa and the famine there. There are so many things one could say about the Horn of Africa, but what I would say is that it is the place on our whole planet that is closest to the edge of mere survival. Every day probably thousands die of extreme deprivation, usually from disease—not visible starvation to death but from immunosuppression, nutritional inadequacy and lack of access to healthcare. This is a routine occurrence and this drought is extraordinarily devastating. It is two full years in which both the long rains and the short rains have failed completely. These are people who have no buffer at all. The climatologists do not know exactly why, by any means, but one theory is that the Indian Ocean has warmed, and that has pulled the convective—the so-called Hadley cell—off the land into the sea so it is raining more in the Indian Ocean and less on the Horn itself. I find that at least a plausible scientific hypothesis.

I think we are going to see a lot of this kind of devastation in many places in the world. It will come in three basic areas. One is agriculture, because we are going to see agricultural collapses. Second, it is going to come in health, because we are going to see epidemic diseases like malaria which, if we are not really on top of them, are going to have a much higher so-called force of infection, because they are temperature-regulated. Third, it is going to come in natural hazards: massive flooding, massive droughts, massive storm events, sea surges and so on.

One can ask, "Climate change and aid?" It is complicated. Climate change will devastate poor countries. We have to understand that adaptation and resilience can be called part of development. Anthropogenic climate change is definitely going to be a huge and costly provocation for us. I would not put new energy systems particularly under this rubric. These are bigger-ticket items, and everything gets messed up for the reasons you are intuiting or expressing very well. You can count things the wrong way, and if it is done haphazardly we are also not going to solve those problems. Climate change is sufficiently complex and sufficiently deep in both its mitigation and adaptation side that we really need a serious policy regime to address it, and we do not have it. We are not getting it the way we are going, for lots of reasons. I am happy to amplify that.

Lord Lawson of Blaby: I do not think that we need to discuss this, but it should be put on the record that most of the great experts in the particular area you have discussed would dissent from what you are saying. But I do not think that we need to discuss it now.

Professor Sachs: We won't go into it, but will you invite me back to talk about climate change sometime?

The Chairman: If we return to it, yes.

Q466 Lord Best: You have responded to quite a few of the criticisms that we have already heard about aid programmes by saying that one needs to be focused, targeted and practical, and not spread out too widely. I think that would mean that, in the places where our aid is focused, a growing quantum should go. Another criticism that I would like you to address is that the inflow of funding distorts private sector investment and will push up exchange rates, which means that people will go for the jobs that relate to aid rather than the jobs that are about wealth creation. This is the Dutch disease, is it not? Do you feel that that is another problem that aid has to overcome?

Professor Sachs: Generally no, actually. If your aid policy is sensible, it will promote productivity on the supply side through the provision of infrastructure or a healthier labour force or a better educated labour force. The idea of aid should be to finance public goods within the country, by and large; it should not be to compete with the private sector. In general, aid should be the things that are complementary to what markets would provide, not the things that markets do provide. Aid in general should not be for consumption, which is the Dutch disease argument; aid should be for investment. Investment in my terms includes investing in health, in education, in nutrition and so forth.

Probably one borderline case where I invest directly in the private sector—let me explain one exception to this because I think it is completely pertinent to the realities of the poorest countries. Almost all the experience that I have of the green revolution, and essentially the jump from traditional agriculture to high-yield agriculture, involves a phase of subsidisation to smallholders. The reason typically is that smallholders are impoverished, are non-credit worthy, have no collateral and have almost nothing, aside from hunger. Typically there needs to be a smart subsidy phase, which is to help introduce fertilisers, high-yield seeds, small-scale irrigation, proper economic practices, storage, organisation of co-operatives or other kinds of farmer-based organisations and so on. This is the long history of the green revolution over the last 50 years. Where it was carried out, it had certainly five years, usually 10 years and, if it was badly managed, you would end up with 50 years of subsidy. I am talking about a temporary subsidy, not a permanent subsidy.

You need that start. That is a private sector activity because smallholder farmers are part of the private sector; indeed, it is the most plentiful employment in the private sector, but it is impoverished. That is what I see in sub-Saharan Africa, for example—we work all over the continent. The typical farm yield is what it was in 1960, yet the population may have doubled or tripled, something horrible in terms of what this means for human welfare, size of farms and so on. But what are the farmers doing? They are using last season's seed and usually, interestingly, the worst of last season's seed, because they eat the better of it, so it is almost the anti-selection approach rather than the selection approach. They do not have fertiliser because they cannot afford it. They do not even have animal manure, so they are on nitrogen-depleted ground, using miserable seed varieties and getting a 1960 yield with a population density that has increased tremendously. This hunger trap is one of the major problems in Africa.

When I started devising on the Millennium Development Goals, no aid agency was working on agriculture. I was told, including at DfID, by the way, and by the Dutch aid agency, "We are not working on agriculture; we are working on the Millennium Development Goals." I said, "Excuse me, Minister, what is the difference? Goal number one is hunger, and the core source of poverty in sub-Saharan Africa is smallholder farmers, so how can you not be working on agriculture?" It has finally begun to change recently, but what is shocking is that in 2009—I worked on this for many years myself to almost no avail—the G8 launched what they called the Global Agriculture and Food Security Program, GAFSP. You do not know the acronym because it is basically dead. The idea was announced at the L'Aquila summit in Italy that year that $22 billion over three years would be invested in smallholder agriculture to help get this green revolution in Africa started. Then our Governments did not follow through. I wanted a fund, based at the World Bank, like GAVI and like the Global Fund to Fight AIDS, TB and Malaria. In fact I modelled it; I drew up the initial guidelines and so forth and the US Government and a few others pledged a lot of money, but basically no one delivered in the end. The last stage of this fund was that 20 countries submitted programmes and eight were accepted, but there is no money to fund them. The technical review panel met, but the board will not meet any more. This is what we do to ourselves. We cannot break out of this trap with this kind of performance.

This is another area where we need multilateral, pooled, practical results. The world has had so many very expensive meetings on hunger, running repeatedly to Rome and running here and there. I said to the Secretary-General, four years ago, "Secretary-General, the only thing I am interested in is how many hectares are planted with proper seed, soil and nutrients; just count that." I would say the amount that has come out of development aid for that purpose is very small. Despite all the meetings and moving people around the world to declare how much they are against hunger, it is shocking to me. This is like vaccines and bed nets; this is practical and deliverable. You put me on any plot in Africa, let me to choose my agronomists and we will get productivity up twofold in a couple of years, if you start at one tonne per hectare. That means that Africa could be self-sufficient in food in, I believe, as little as five years. But that would take a tremendous, organised effort, which our Governments have not been able to demonstrate.

The Chairman: Professor Sachs, we have quite a number of questions still to come, so I would be grateful if you could try to shorten your answers.

Professor Sachs: Sorry. You can see that it is my favourite subject.

The Chairman: Exactly, but we have a limited amount of time.

Q467 Lord Levene of Portsoken: Professor, there are some new players on the block. You now have India and China coming in. In your long experience, are they seeking the same goals as the more traditional players? Do they in fact have more political intent behind what they are doing? What are they looking for and what effect do you think that will have on the traditional players?

Professor Sachs: China is a huge player in Africa already. Wherever you turn around, China is there and it is there more visibly and more actively than most of the rest of the donor world. On the whole, what China is doing I find to be constructive and very practical in general—not always. They are building a lot of roads, a lot of power plants and several dams—physical infrastructure—and it is making a contribution. They are also building a lot of stadiums, a lot of presidential palaces and a lot of Parliaments, and some of that I could do without, frankly—not the Parliament, of course. They ask a President what he wants and they are told, "We want a giant stadium." I would leave the stadiums to those countries themselves.

But what China is doing clearly has many motivations, not different from those of many other Governments. They want geopolitical influence; they want access to natural resources; and they want diplomatic friends. I do not find anything especially untoward in what they are doing. I see a lot of it. The difference is that there is no political conditionality at all. I have to say that in general—I want to say this right—I believe development aid should be for development. So I believe that our form of political conditionality is often not effective in any event. As I said earlier it is putting a load on an instrument that cannot bear that load. In this sense, when China does not subscribe to our standard of, "Why don't you stop aid to this country, as the election process is not right in this or that way?" I still would like that country to get the road, or still to have electricity, or still to have some other things. I do not think that *we* have it exactly right. I am not condoning bad governance; I am talking about the instrument of development assistance, which I take to be a pretty focused, targeted, specific, limited policy.

I have had occasion, not surprisingly in this work, over 25 years, to have a lot of experience of watching donors from the other side of the room, when the door closes. Governments are not going to fix themselves over our aid; they may have plenty of reasons to fix themselves and I hope they do and I advocate it. I am a strong supporter of democratisation and other things, I just do not believe it can bear the load. When we complain about China supporting this or that Government, often this is not really hitting the mark on a practical level.

Q468 Lord Levene of Portsoken: Are you saying that, if you do not fuss too much about the proprieties, at the end of the day they are getting more done?

Professor Sachs: They are getting a tremendous amount done and, boy, are people seeing it. Now, they are making mistakes also. They bring huge platoons of workers and that leads to backlash and unhappiness. They are fixing that, though, pretty quickly. They are learning to bring foremen and to hire a lot of local workers. But they put up roads faster than anything that I have seen. When I drove into a capital recently, they pointed to the left-hand side and said, "See that factory? That factory is producing all the asphalt for this country. Do you know, Professor Sachs, that 90 days ago that factory was not there? This came in containers and was assembled almost overnight by Chinese workers and now China is building all our roads." So one should understand that this is a massive geopolitical change underway.

Lord Levene of Portsoken: So they get more bang for the buck.

Professor Sachs: They are getting a huge response for what they are doing.

Q469 Lord Tugendhat: Professor Sachs, I imagine that you would agree that a major incentive for Chinese aid is the desire for access to raw materials. Putting aside the presidential palaces, the stadia and things of that nature, is not much of what they do actually very similar to what the big western mining companies and other direct investors do? The mining companies open mines, and the Chinese do that; they build roads, and the Chinese do that; they develop supply chains, and the Chinese do that. They also tend to build hospitals and other things of that sort. When people talk about the nature of Chinese investment, it seems to me that in important respects it is not so very different from what western mining companies do, except that the western mining companies do rather more in terms of labour rights, safety and things of that sort, which you were just indicating the Chinese are now getting their minds round.

Professor Sachs: I think that there is one difference, which is that these roads, power plants and so forth are not simply dedicated to the mining site. They are really doing national projects. The leaders of the countries understand that this is the first time someone is taking seriously the idea that there ought to be electricity in country X. That is very much appreciated, by the way. So China is doing more than the mining companies because mining companies build infrastructure to their enclaves. One thing that I am working on with a number of mining companies is multiple-purpose use of their infrastructure, so that it is not simply developing an enclave but is a road that can be used for the whole corridor. We are working in Mozambique, for example. There are huge coal mining sites in northern Mozambique. It will come in a corridor to the Indian Ocean and I am working with the Mozambique Government so that what they call the Nacala and the Beira corridors are developed on the basis of that broader rail, road and power infrastructure, which a mining company might just, in a very direct way, regard as their personal, private infrastructure to get coal to the port. But I do not think that that is really what China is doing. China is using its geopolitical influence also to gain access to these resources, but it is not just building hat is no different is what we do—period. They are just doing it more, by the way. It is not unusual for any of our countries to be promoting the presence of our private companies as concession holders for any of these resources. We do not do it as a Government so directly, but we do it indirectly. We use a lot of our political sway and as much persuasion, and there are perhaps looser linkages, but they are playing the same game in this sense. I have to say that my net-net evaluation of this, if I could put it that way, is that China is making a real contribution to the physical infrastructure of Africa and is being seen to be doing so. The net for Africa is beneficial, so I am encouraged. I wish we would do more, not in the purely commercial sense, but I wish we would do more in the realisation that financing infrastructure is a good thing.

Maybe I should just come back to one point on aid. I happen to believe that a great deal of the infrastructure that Africa needs—power, roads, ports—is financeable by loans, not by outright grants, but we do not have this process working properly right now. The IMF, strangely enough, has blocked a tremendous amount of these loans because the IMF has loan ceilings that it imposes on its debt-sustainability analysis. In my view, the way that they have done it in the past is very bad economics. They do not see that these are investments with a return. What they do mechanically is say, "Here's your growth rate. Now if you add on all this debt, the debt-GNP ratio is going to go up to a point you can't afford." What they should be saying, of course, is, "Here's a baseline but, if you add electricity, here's a new baseline." And, by the way, people pay for electricity, so this is project financing; it is not grant financing. Believe it or not, to this moment this is an unsolved problem. It is so weird, because it is the most basic economics and there are very bright people in the IMF, but we cannot make a breakthrough on this.

Q470 Lord Tugendhat: I just wonder whether there is not a slight element of rose-tinted spectacles. Anybody who is after resources is going to build roads and so forth. If they want to be getting on well with the Government, they will not just build a road from the mine to the port. In the case of the Chinese, there is sometimes a certain ruthlessness about directing the infrastructure to their particular needs, of which the plan to build a road across the Ngorongoro crater in Tanzania, regardless of the environmental and other implications, is an example. I am not suggesting that the Chinese are unique in this; I am just suggesting that I think that you are putting a slightly rose-tinted view of them.

Professor Sachs: May I give you one example? We had a famous case of the Chad-Cameroon pipeline. The investors were Exxon and others. The only power plant that went into Chad was for the power to pump the oil out of Chad. Talk about infrastructure that was 100% devoted—

Lord Tugendhat: But there are examples the other way also.

Professor Sachs: This was a country with no infrastructure and a limited amount of oil and we basically found under the World Bank's watch, a way to deplete that resource and leave fuel wood behind. That is a shame on our side.

Lord Tugendhat: There are other examples, though—I mean better examples.

Q471 Lord Lipsey: I wonder whether you could talk a bit about the role of private sector investment in these countries and in particular its relationship with aid. Potentially, and in many cases actually, these flows far exceed the likely flows of aid money. We have heard quite a range of evidence. One organisation purported to show that private investment had no impact whatever on the growth rates of developing countries and others have said that it is a much more effective way than aid of creating development. Could you give us your take on that?

Professor Sachs: I would think it extraordinarily odd to have any kind of blanket statement that private investment would not contribute to growth. That is unimaginable, except if it is private sector investment led by the most failed businesses imaginable. That private sector investment is presumably chasing a return and private investment is fundamental to economic development. Of course, countries need foreign private direct investment. This has proven to be one of the most powerful channels of economic growth and it is quantitatively of huge significance. The only point that I would make is that the private sector can do certain things. It should build and run mines; it should build and run factories; it can run banks; and it can do many things. I do not believe that private investment is the leading edge for malaria control, for health services, for the educational system or even for the infrastructure, because when I say that it can be lent commercially, I am generally thinking about project financing around government rather than a private contractor. If it is a private contractor, as this country knows very well, it is with an extraordinary amount of oversight and definition of the role, because it is generally some kind of private monopoly. The point is that it could never be, on any basic logic of economics, never be private versus aid; it has to be both, but it has to sort out which and for what.

Adam Smith gave us Book V of *Wealth of Nations* to tell us what part the Government should do. He got that mostly right in 1776; great book. Preceding that, he gave us four books about what the markets should do and he got that mostly right. So I think that we have known for a very long time that public works, public education, public health and a few other areas are purviews of the public sector and that most of the rest is a purview of the private sector. I gave the proviso of the trap of impoverished peasant smallholder farmers who need that help to reach a stage of creditworthiness, but, short of that, a private investor should love public support for infrastructure, health, malaria control and other things. If I were a private sector investor, I would be so gratified to know that malaria has come down, that children are in school and that hunger has been reduced. To me that would say, "This is a country I can invest in." I view these as entirely complementary investments, not either/or. It is unthinkable to my mind for anyone to say that private investment makes no contribution to growth. Unthinkable. I cannot even imagine what, except bad econometrics, would lead anyone to make such a statement.

Q472 Lord Shipley: You said earlier that war-zone aid was not development aid. I wondered whether you could draw any conclusions from recent research on conflict-prone and fragile states.

Professor Sachs: What I do not regard as development aid is giving money to the Afghan Government as cash support for their budget. That is what I am talking about. There may be reasons for that, although I am not too enthusiastic about the reasons. But one could conceive of true aid in either conflict-ridden countries, or countries coming out of conflict, or countries that are vulnerable to falling into conflict, about which Paul Collier has written eloquently.

What I would say, in those cases, is, "Focus on what aid can do." I will give an example. In Afghanistan, we have spent a fortune to get very little, both on the war and on development, it is sad to say. Incidentally, the official data of the amount that we spend on the war effort is something around six times Afghanistan's GNP, which is shocking. If you spend on war effort six times GNP, I guarantee that there is a better way to achieve foreign policy goals, as well as development goals, than spending $1 million per US soldier per year, which is what we are doing right now. This is the least cost-effective way to try to stabilise the situation in Afghanistan that I can imagine. If you give me $1 million, I would say we could help to make a village self-sustaining and food-secure. That is a village as opposed to one young man or woman from I do not know which state of the United States, there for a year, who is, I am sad to say, in the line of danger and not, in my opinion, contributing to Afghanistan's stability or long-term development.

The question is what to do. On Afghanistan, I pleaded with the US Government on occasions to put in more development outside the war zones in Afghanistan—more in the north, for example. They said, "No, no, no; we have to do development right in the conflict zones." This is a little strange, I have to say—very unimaginative. It is like saying that we have to pump up the tyre by putting the nozzle at the bottom because the tyre is flat at the bottom. You could do development by showing how agriculture can work in the north, where you are not being shot at everyday. You could help to bolster these communities, civil society and the idea of development. You could help conflict-ridden sites say, "Oh, my God, look what's happening there. My cousin is eating properly. There's a school for his kids and other things are happening," but the US, unfortunately, in my opinion, did not find a way to do that.

You have to be clever. In my view, on these conflict zones, what is the most important thing? Agriculture, for example, and livelihoods. In general, people either have guns in the militia or a paramilitary group or they are farming. Help agriculture; help create food security; help create an absence of hunger; help disease control; and provide help for some community-based development. Those are all very practical, monitorable and measurable kinds of impacts. I believe this can have a very big effect on reducing the possibility of falling back into war if you are coming out of conflict. I believe it can have a big effect on stopping a descent into war. I do not know about war zones themselves because I have never worked in one. I do development but I do not work where the bullets are flying.

Q473 Lord Shipley: Let us take the very specific example of South Sudan. Imagine that you are in charge of DfID and you are in a meeting talking about what to do in South Sudan. What would you say?

Professor Sachs: One thing is that South Sudan has a lot of resources. They are impoverished, they have no paved roads and it is a desperately impoverished situation, but they have a lot of oil revenues. The first thing that I would say is, "Let's try to think through how decent public investment can be made." My impression is that a huge amount of their oil revenues is going into military personnel, so there has to be a decommissioning and there has to be a use of those same revenues to help build the country. What they need more than anything else is a basic strategy. This is a revenue-rich country that is utterly impoverished and what they need is a strategy to build the most basic human capital and infrastructure capital. That is core development work, so that is something to which DfID could contribute—not to be too grandiose, but to be very pragmatic, very mission-oriented and very low-cost. Those are their own revenues. How much more they need even beyond their own revenues I am not sure because I have never seen it properly accounted in the very specific case of South Sudan. They do have a lot of money from oil, which should be put to first use and not squandered on the military.

Q474 Lord Smith of Clifton: Professor Sachs really covered the question that I was going to ask originally, so I will move on to the next one. One of our witnesses, Michela Wrong, paints a chilling picture of a possible African spring in which authoritarian rulers of former donor darlings use their revamped internal security systems to suppress domestic political opposition. How should aid to weak states be configured to support development but avoid these kinds of adverse effects?

Professor Sachs: This is the same difficulty that I have been talking about on several occasions. I do not think that we can run these countries or can use aid to make them run in the way that we would like. I am quite sceptical about that. I do not think that our aid is big enough and I think that the politicians care more about the politicians than they do necessarily about what the loss of aid would be if it were used in the direct sense of going to core political issues. I am perfectly satisfied, by the way, with our diplomats saying, "This is inappropriate, this is wrong. The jailing of these opponents is unacceptable." I am all for that completely. I am all for us promoting our democratic values. I think that is appropriate and I think that is smart, but I do not believe that a malaria programme can get turned on and off in this way. I do not believe that almost any appropriate development programme is best served by conditioning it on our test of the political process this way, subject to the point that all of us would have a breakpoint, but my breakpoint is probably further away than other people would like. I believe that there will be non-democratic Governments in poor countries. I believe that helping countries to develop will be a route to democratisation, because one of the most powerful, basic findings of all our political history of the last century is that, if economic improvement takes place, it is a powerful force for democratisation. I would argue also that the burden that we put on development aid is too big for it to handle. In this sense, I may not meet your witness's standard. It is not because I love a bad regime, and I would not give aid to a brutally murderous regime—I also have my limits—but we have definitions sometimes that are basically not about mass murder or not about even mass repression but about the standards of politics. I could share the sentiment, but I do not think that it means turning off the development assistance.

Q475 Lord Tugendhat: Professor Sachs, you have spoken very well, as others have, about the effectiveness of the British aid programme, and that is good to hear. I wonder, though, what you think about the idea of having a legislative commitment to an arbitrary percentage of GDP. Do you feel—obviously, you are first and foremost an economist—that this is putting supply before demand and that it risks encouraging people to spend money without evaluating too carefully what it goes on? Much of the evidence that we have had has been directed towards getting value for money from aid, ensuring that it goes to the purposes for which it is dedicated and that it is not abused, as came out in the last question. Do you think that there is something perverse about incorporating or embedding this arbitrary figure in legislation? Should we not be more demand-driven rather than supply-driven?

Professor Sachs: In the case of UK aid, I have no doubt that the UK will be able to direct 0.7% of GNI highly effectively, if it chooses to do so, without finding an embarrassment of riches, as it were, that there is no place to deliver to. The uses and the needs for effective delivery go far beyond what the UK alone can provide. The target that the UK has set has been the international guidepost for 41 years. It is enshrined in countless international documents. I participated in endless summit meetings where 0.7 has been proclaimed and reproclaimed again. It is not arbitrary either. It came out of the Partners in Development process of Lester Pearson. Originally, incidentally, it was to be 1% of national income, of which 0.7 would be official aid and 0.3 would be civil society and private commitments. When I led the UN Millennium Project, we found—and it was not a finding of convenience—that the 0.7 was a snug fit with what is needed to achieve the Millennium Development Goals, so I do not find it arbitrary. Given that it is enshrined in international processes and I am probably in the institution in the world where tradition has been most important, I would say, "Go for it". The world cheers you on. It is money that can be extraordinarily well spent and well rewarded. I think the UK will reap tremendous national benefits from honouring this cross-party commitment. I take the occasion everywhere in the world—and believe me, I do—to say how impressive it is that at a time of economic stress the UK is following through on this commitment. It is not pulled out of the air; it is pulled out of history, but it has a merit that is quite deep. It is not forever, also. I hope that I can come here and we can all share the experience of the end of extreme poverty and the end of aid itself, as I describe, because countries should graduate. That is absolutely possible and I will be happy to cut the ribbon or to watch the ribbon cutting when the last country on the last aid is officially designated as the graduate of this process. So this is not for ever, but it is important right now.

Q476 Lord Smith of Clifton: Professor Sachs, when you say that it will redound to the credit of the United Kingdom that we have met this, apart from your very complimentary statements about Britain when you go around the world, how will it actually impact in terms of Britain's reputation? What will be the tangible benefits coming to this country?

Professor Sachs: I think that all over the world Governments have stood up and civil society has stood up and said, "Frankly, what the UK is doing is amazing." There have been five countries at 0.7 for a couple of decades—all northern European countries. Britain will be the next one, and the biggest by far. The UK also, because of its very long and distinguished history, is the intellectual leader of this process. DfID plays a role that has absolutely outsized the financial commitment, which is significant. The intellectual leadership is absolutely crucial. DfID does not always get it right by any means, but I think that it is getting it right now. I have had my tangles with DfID in the past but I think that the country is absolutely on the right direction right now. UK leadership in this area is absolutely recognised as being distinctive, very special, a mark of this country. It is a reflection of a long history, a reflection of the Commonwealth and a reflection of intellectual knowledge and leadership. The London School of Hygiene and Tropical Medicine is but one of many, many institutions in this country that are unique in the world and that also played this phenomenal role. This is known. As to how to quantify it exactly, all I can say is that it is quantified in hearts and minds around the world and it will be noted.

Q477 The Chairman: Mr Sachs, you have just said that DfID is getting it right now and you were critical of some of the directions in the past. Could you say a little more about where you think it is getting it right now and what has changed?

Professor Sachs: I think that the emphasis on results orientation right now is extremely important and the fact that this Government, in a very practical, pragmatic way, is saying, "We want to see what this is doing," is very important. The fact that the UK played a major role in GAVI's replenishment is extremely important. The fact that the UK is chairing the Global Fund to Fight AIDS, TB and Malaria is very important, although I am extremely worried about the inadequate financing of the Global Fund right now. The biggest single risk to the MDGs that we have is that Round 11 of the Global Fund was suspended a couple of weeks ago. It is actually a very practical and immediate danger and the reason for that is that the other countries are not coming in properly right now. Even the US pledge is shaky, even though the US insists that it is not shaky. It agreed with the board of the Global Fund to do a "risk-adjusted pledge" and the board said, "We don't have the cash to go forward with this current round of financing." So I have suggested to DfID and to the Secretary of State today and I have written a letter to the board that this round absolutely urgently needs to be reinstated. Having said that, this is an example where the UK is playing a leadership role that is fundamental. It has a very deep and well known economic logic; it is specific; it is technological; it is measurable; it is monitorable. We could see huge impacts in the short term, but we have not gotten the public investments up yet to do that. So that is one area.

The second area where I personally would love to see UK leadership is on population, fertility and family planning. This is, without question, one of the high-risk points for Africa's success. It is perhaps the most important, and it is a very difficult one because of the sensitivities around this issue. It is a taboo subject in many places, but it is not a taboo subject here. It needs to be an open, properly analysed and properly led subject. As you probably saw from the UN Population Division 2010 revisions, the current trajectory of population for Africa is that it will rise to something on the order of 3.3 billion people by 2010, roughly a third of the world's population.

Lord Lawson of Blaby: By when?

Professor Sachs: By 2010—sorry, by 2100, excuse me. This is untenable for any kind of development success, viewed over the longer term. There is the ecology, the environment, the fact that farms are already down to a half a hectare in many countries, squeezed beyond anything I can imagine for one more generation, and many other considerations. It suggests to me that a rapid, voluntary-based decline of fertility rates is yet another of those end points to which development assistance, properly targeted, measured and monitored, could have a huge effect. These are all areas where I think this Government and DfID, in general, are pointing in the right direction right now. The criteria that I have suggested can be applied in a very tough-minded, warm-hearted way that will actually lead to very sound results.

Q478 The Chairman: You said in answer to Lord Tugendhat that the UK has stood high in relation to its 0.7% commitment in the world at large. I think that is largely in the aid community, because the general public does not have the same attitude towards that sort of target. That has obviously been over many years. You have also welcomed the changes that have taken place under this Government in the last year. Do you think that, given the plaudits about the 0.7%, there will be substantial support for the new directions that this Government are taking in the aid community at large?

Professor Sachs: I think that there should be and I suspect that there will be, because the areas of specific focus and interest, like GAVI, generated a huge response in the aid community and the UK led. I should add that Norway is always a good partner of the UK in these things. You saw that the replenishment of GAVI went brilliantly. I think the UK should take a lot of feeling of a good result from that. I think the same can happen across many of these areas. So I would not see any downsides. It is a bit tougher love, but that is what I would recommend. In fact, it is the only way, in my opinion, to keep the public on side on this; which is to show real results. I do not think that being soft on development assistance gets you very far and I like this approach, we want to see the results; we want measurability; we want accountability. These points of emphasis are well taken and work to keep the UK public on side on all this. It is a very good example for the world.

Q479 The Chairman: I think that you have almost answered my last question, which was really that, as you indicated earlier, countries' economies are going to go through intense pressure in the next two or three years and there will clearly be a public out there that say, "We are now having to cut back on our resources, and our incomes in real terms are going to be cut, so why should we pursue an aid programme to some countries where a lot of the money gets squandered and goes to Governments and into other pockets?" That will be the general public's reaction. What would be your answer to that?

Professor Sachs: My answer is that all of our Governments—this one, my Government and so on—have to take care of our own poor and indigent first, because if we do not, then there is no answer on this. The UK starts with institutions like the NHS, which I think are vital. The US does not have such institutions, by the way, so the public support for development aid is even less, but we are pretty nasty to our poor in the United States right now. The social safety net has really been taken away. I do not think that there could ever be a country so noble that it would say, "Our own poor are being sacrificed for the world's poor." I would never recommend that because I do not think that would be noble; I think that would be foolish.

The justification for this would be that the UK can honour its domestic needs absolutely and that these obligations are not taking away from core domestic needs but are serving the country, its broader purposes and the humanity of the UK people, because we all really do feel the need to have confidence in our public institutions and what they are doing in the world. One of the things that was most powerful in the US case, which is not a country that is particularly attracted to this agenda, was that George W Bush—much more than Bill Clinton, and much more, I am afraid, than President Obama—led the increase of development aid in the United States in the fight against AIDS and malaria, and brought the US into the Global Fund. He then created the two national programmes, PEPFAR and PMI. The point I am making is the following: the US rallied to that, contrary to all the political experts, who said, "No, you can't do this; this won't work." Actually, a rather conservative constituency of President Bush, because in that case it had a strong religious component to it, was at the core of this initiative. President Bush regards this as perhaps his favourite legacy. I cannot put words into his mouth but I know that it is one of the things of which he is proudest about his Administration. The American people have definitely backed this strongly.

I believe that as long as the UK is paying attention to those in need here, even in these difficult times, the public will rally to this role internationally as well. It is not 7% of GDP but 0.7%. There is a limit to what one can do, but as along as it is 0.7%, I think it is okay. Incidentally, as there was some discussion, now that growth is a little lower, DfID's point is that maybe it should go above 0.7%. No, achieve 0.7%. This is a huge contribution for the world. That is the standard. You do not have to go beyond 0.7% right now. Honouring this global commitment is a magnificent accomplishment. In the difficulties that all countries are facing, I do not think that going beyond that is either needed or called for. Setting the example and doing it and achieving that goal will be extraordinarily powerful for the world.

The Chairman: Professor Sachs, I think that is a very good note for us to end on. We have covered an awful lot of ground this afternoon. We are very grateful for your contribution and particularly grateful to you for coming to give it to us. Thank you so much.

Professor Sachs: Thank you for the opportunity.

Save the Children—Written evidence

Introduction

Save the Children is the world's leading independent children's rights organisation. We're outraged that millions of children are still denied proper healthcare, food, education and protection and we're determined to change that.

This Save the Children submission focuses on 5 of the 12 questions asked in the Call for Evidence[388]. We focus on the relationship between ODA and growth, the factors that determine the effectiveness of ODA in recipient countries, how ODA should be allocated and how best to allocate ODA in fragile states where there are security concerns.

How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, wheat has been the impact of British ODA? How robust are results from studies in this area?

Academic study of aid and growth

How aid affects the economic growth of developing countries has long been the subject of academic study. In 1972 and 1973, Papanek found a positive relation between aid and growth[389], as did Singh[390] (1985), Snyder (1993)[391] and Fayissa and El-Kaissy[392] (1999). Burnside and Dollar (1997) claim that aid works well in a good policy environment, which has important implications for donors, multilateral aid agencies and policymakers in recipient countries[393]: "Developing countries with sound policies and high-quality public institutions have grown faster than those without them, 2.7% per capita GDP and 0.5% per capita GDP respectively. One percent of GDP in assistance normally translates to a sustained increase in growth of 0.5% per capita.[394]" These studies show that aid spent effectively and backed with an environment of good policies can lead to significant impacts on economic growth.

Other academics have claimed that aid has a negative impact on growth, saying it erodes institutional quality and increases rent-seeking and corruption.[395] The academic debate on the relationship between aid and economic growth continues. However, at Save the Children, we believe that using aid to develop the capacities of children can and does result in substantial economic returns.

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388 http://www.parliament.uk/documents/lords-committees/economic-affairs/Development%20Aid/CfE16May11DA.pdfn

389 Papanek, G. (1972). "The Effect of Aid and Other Resource Transfers on Savings and Growth in Less Developed Countries." Economics Journal 82; Papanek, G. (1973). "Aid, Foreign Private Investment, Savings and Growth in Less Developed Countries." Journal of Political Economy 81, pp.120-130

390 R Singh, 'State Intervention, Foreign Economic Aid, Savings and Growth in LDCs: Some Recent Evidence' Kyklos (1985) Vol 8, Issue 2.

391 Snyder, Donald W. (1993). "Donor Bias Toward Small Countries: An Overlooked Factor In the Analysis of Foreign Aid and Economic Growth." Applied Economics, 25, 481-488

392 Fayissa and El-Kaissey (1999), 'Foreign Aid and the Economic Growth of Developing Countries (LDCs) Further Evidence' Studies of Comparative International Development Vol 34, No. 3, 37-50.

393 Burnside and Dollar, 'Aid, Policies and Growth' World Bank Policy Research Working Paper No 569252 (1997).

394 Vu Minh Duc, 'Foreign Aid and Economic Growth in the Developing Countries - A Cross-country Empirical Analysis' available at http://cnx.org/content/m13519/latest/

395 Knack 2000

Investing in education

Although there are many variables which affect the relationship between a child's education and their subsequent productivity, studies show that there is significant correlation between investments in education and increased economic growth.[396] Spending on education has a direct effect on the accumulation of human capital, which increases the quality of labour, and in turn increases economic output and produces higher growth rates.[397]

Other work shows that when developing countries have a well skilled labour force and hence are able to effectively develop new technologies, or adopt and use foreign technology, they are able to compete with more advanced economies. This can become a source of self-sustaining growth[398]. Aid invested in education is therefore not only a social good, helping to realise children's rights and meet the Millennium Development Goals, but also makes economic sense. In a study of aid spent on education, it was found that aid targeting primary level education was the most growth enhancing.[399]

Investing in child survival and family planning

It makes intuitive sense that investing in children's survival will result in higher economic growth. Research by Save the Children shows just how compelling and decisive these investments can be.

Undernutrition kills more than 3 million children every year, and prevents hundreds of millions more from achieving their full potential. Undernutrition can reduce gross domestic product (GDP) by as much as 6% a year. Globally, the direct cost of child undernutrition is estimated at between $20 and $30 billion.[400] Using aid to improve the nutrition of children can therefore accelerate economic development and poverty reduction. Globally it has been estimated that preventing illness can save US$700 million per annum, for child survival alone.

Meanwhile, every dollar of aid targeted at family planning saves four or more dollars of subsequent expenditure tackling the complications of unwanted pregnancies. The economic benefits of reductions in child mortality and controlled fertility rates are evident in Asia. According to the UN, between 30% and 50% of Asia's economic growth from 1965 to 1990 can be attributed to improvements in reproductive health and reductions in child mortality rates.[401] The UN's *Global Strategy on Women's and Children's Health* recognises that in other parts of the world maternal and newborn mortality continues to slow growth, leading to annual global productivity losses of $15 billion.[402]

Growth alone will not end poverty

There is no doubt that economic growth can be a powerful tool for reducing poverty in developing countries, indeed evidence suggests that "poverty eradication has been most

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396 Blankenau, 'Public Schooling, College Subsidies and Growth' Journal of Economic Dynamics & Control 29 (2005) 487 – 507; Cullison, W., 1993. Public investment and economic growth. Federal Reserve Bank of Richmond Economic Quarterly 79, 19– 33

397 Blankenau, W.F. and Simpson, N.B. (2004), "Public education expenditures and growth", Journal of Development Economics, Vol. 73, pp. 583-605.

398 A Asiedu and B Nandwa, 'The Impact of Foreign Aid in Education Growth' UNU-WIDER (September 2007).

399 Asiedu and Nandwa (2007). Note that the authors use a disaggregated data to ensure that the heterogeneity of aid and heterogeneity of the recipient countries is recognised

400 Save the Children (2010) Investing in Children's Nutrition – The Economic Benefits, Policy Brief, April 2010, Save the Children UK: London.

401 UN, Global Strategy for Women's and Children's Health, September 2010, http://www.who.int/pmnch/topics/maternal/20100914_gswch_en.pdf

402 United Nations, September 2011, http://www.who.int/pmnch/topics/maternal/20100914_gswch_en.pdf, P. 6

pronounced in the regions where growth has been the largest"[403]. Where aid is invested in child-oriented services, there are demonstrable effects upon the alleviation of poverty and the stimulation of growth. But years of experience in delivering essential services, in low income and middle income countries (where the benefits of economic growth are unevenly shared) has shown us that growth alone will not end poverty[404].

When growth is measured in terms of the average increase in income per capita, we often miss the fact that large parts of the population – those from a certain geographic area or socio-economic group, for example – may not be sharing in its benefits. This can be seen in the case of India's rapid growth, which has not significantly benefited the poorest 40% of rural households[405]. Similarly, aggregate poverty statistics can also hide movements of different groups into and out of poverty over time[406]. For this reason a focus on growth alone is insufficient.

According to Maxwell "growth, even pro-poor growth, needs to be complemented by measures to reduce asset and income inequality – equity has an instrumental logic (redistribution can make growth easier and poverty reduction faster) but also has intrinsic value in a fair global society".[407]

What factors determine the effectiveness of ODA in recipient countries? Are they dependent on the scale and form of aid flows? How is aid effectiveness monitored?

Aid modality contributes to aid effectiveness
As testified to by the Paris Declaration Evaluations and Monitoring Surveys[408], a single development strategy with nationally owned objectives by donors is one of the most effective ways to deliver ODA. An example of this can be found in Uganda, where the President made a decision to introduce universal primary and secondary education. Coordinated donor support to the education sector supported the implementation of the policy through funding, policy dialogue and conditionality. This support coincided with a significant increase in the enrollment rate for primary schooling and completion[409].

In order to promote country-owned development policies and strategies, the Paris Declaration commits donors to ensure that they are doing all they can to align their support to local efforts, including ensuring that their aid is recorded in national budgets, put through local systems (the most progressive approach to doing so being budget support), and avoids using parallel systems. Thus, the form of aid flow has an important impact on the effectiveness of ODA. For example, budget support, which supports national development

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403 R J Barro and X Sala-i-Martin, Economic Growth, Second Edition, MIT Press, 2003, p 10
404 A Minujin, J Vandemoortele and E Delamonica, 'Economic growth, poverty and children', Environment and Urbanization, 14, 2, 2002, pp 23-43; R Gottschalk, P Martins and S Hague, Pro-poor Growth: The evidence beyond income, presented at the ESRC Development Economics Conference, September 2008
405 Save the Children (2010) Children and Economic Growth, http://www.savethechildren.org.uk/en/docs/Children_Growth.pdf
406 Waddington, H (2004) Linking Economic Policy to Childhood Poverty: A review of the evidence on growth, trade reform and macroeconomic policy; CHIP Report 7, Childhood Poverty Research and Policy Centre, London
407 Maxwell, S. (2005); The Washington Consensus is dead! Long live the meta-narrative!; ODI Working Paper 243, London, p.6
408 For example; http://www.oecd.org/document/60/0,3746,en_21571361_34047972_38242748_1_1_1_1,00.html
409 "Sector Budget Support in Practice – Good Practice Note", Box 1, page 10, ODI/ Mokoro, February 2010

objectives, is more effective then project aid, which is more fragmented and involves higher transaction costs.

Budget support as an effective way of delivering aid
Both general and sector budget support have had a positive impact on the delivery of essential services by lessening the bureaucracy associated with receipt of aid funds, freeing up time and resources for more judicious investment, and improving national planning and budgeting processes. Evaluations have concluded that budget support increased the quantity of service delivery in seven out of eight countries, usually in basic education or health[410]. DFID country offices using budget support were twice as likely to report improved access to services over a five year period compared to country offices not using budget support[411].

In 2008 Oxfam and the European Commission undertook an evaluation of the impact of the Commission's general budget support. In eight of the largest country recipients of budget support, government spending had increased by nearly a third. All but one experienced an increase in children's primary school enrolment - in Madagascar, the number of children enrolled in primary education increased from 69% to 92% in one year[412]. An ODI study of 10 sectors in 5 African countries demonstrated that the use of sector budget support (aid going to one particular sector of the national budget e.g. health or education) led to more support for the expansion of service delivery; improved planning and budgeting and financial management; more predictable aid flows; and improved policy implementation, which strengthened government accountability and ownership of policies[413]. The introduction of free basic services - such as primary education in Rwanda, Uganda and Mali, and free basic healthcare in Zambia - as a result of sector budget support has increased demand and service uptake. In Uganda and Rwanda there was a notable expansion in primary education following the provision of sector budget support.[414]

How should ODA be allocated? How far do (and should) the Millennium Development Goals (MDGs) shape aid allocations?

To ensure that aid is delivered most effectively (and in context of budgetary constraints) it should be focused on children and child-focused development. This holds true for a number of reasons:

The social benefits of child-targeted aid
In many developing countries, children and youth constitute close to half of the national demographic, and in most regions this figure is steadily increasing. It is estimated that, by 2050, the number of youth (aged 15-24) will have risen by 38% since 1950 and that 9 in 10 youths will be in developing countries [415]. The burgeoning demographic of children and youth means the needs and concerns of this social group must be adequately incorporated into national planning.

[410] Joint Evaluation of General Budget Support 2006; Evaluations of budget support in Tanzania (2005) and Ghana (2007) by the ODI
[411] NAO survey of DFID country offices
[412] Fast forward- How the European Commission can take the lead in providing high-quality budget support for education and health
[413] Tim Williamson and Catherine Dom, 'Sector Budget Support in Practice Synthesis Report' ODI February 2010 pg x-xi.
[414] Ibid, pg 12.
[415] Population Reference Bureau (PRB) (2009) World Population Datasheet, Washington D.C: PRB

A strong focus on children within development is also essential to prevent the intergenerational transmission of poverty[416]. A strong policy and programmatic focus on children's development and wellbeing can help break the cycles of poverty that deprive children of their rights to education and health (for example), which present a lifelong obstacle to their development[417]. Employing a strategy that helps to prevent this inter-generational transmission of poverty is an effective means to ensure sustainable poverty reduction.

The economic benefits of child-focused aid

Focusing poverty reduction and development efforts on children and young people is not only strategic because of the dramatic economic returns that can result from investment in childhood, for whom windows of opportunity tend to be more finite[418]. Focusing poverty reduction efforts on overcoming their poverty and deprivation, and on the attainment of their rights, is instrumental for development of human capital and the social potential of future generations.

According to Sen (1999), the capabilities that adults enjoy are deeply conditional on their experiences as children. First, they can directly make adult lives richer and less problematic, since a secure childhood can improve the capacity to live a more stable life, with greater opportunities. Second, childhood preparations and confidence contribute to the ability of adult human beings to earn a living, to be economically productive, and to contribute to their society. There is evidence of higher rates of school enrolment raising economic growth through such factors as higher wage rates[419].

The political benefits of child-focused aid

Using a child-focused lens helps us better understand the links within and between different household members' experiences' of poverty. There are complex forms of vulnerability that can induce or perpetuate poverty, making effective, comprehensive approaches to tackling poverty reduction, which result in a more judicious use of resources, all the more important. Fostering a deeper understanding of a population's specific vulnerabilities, and targeting these problems, is also likely to lead to more widespread popular political support for development.

Does ODA complement or inhibit private investment in developing countries?

Sustained economic growth is a powerful tool for reducing poverty in developing countries. Some of the greatest successes in poverty reduction have occurred in regions where growth has been largest. However, the ways in which growth is distributed is of greater importance than the pursuit of growth for growth's sake.

416 Castañeda T. and E. Aldaz-Carroll (1999) The Intergenerational Transmission of Poverty: Some Causes and Policy Implications, discussion paper, NY: Inter-American Development Bank (IADB)

417 According to a recent ODI study of past economic crises and the impacts on children, compromises in children's education in the face of lower household income are common. Parents are often forced to draw on children, either for care of their younger siblings while parents work longer hours or for their capacity to provide additional labour. These interruptions in a child's education can compromise their long-term development and potential for future economic productivity (Harper et al., 2009).

418 Missed opportunities as a child may be difficult to overcome and have lifelong and irreversible effects (Harper and Jones, 2010).

419 Murrugarra, E., (1998) Completeness of markets and economic shocks, Lima: Mimeo; Schultz, P.T. (2003) 'Wage rentals for reproducible human capital: evidence from Ghana and the Ivory Coast', Economics and Human Biology, Elsevier, vol. 1(3), pg. 331-366

Private-sector-led growth in unregulated markets does not always translate into inclusive growth. In market economies, this can be a result of a lack of access to markets for poor people, as well as the terms on which they participate in them. In countries such as Cambodia, Honduras, Uganda and South Africa, for example, growth has actually contributed to increases in inequality.[420] Furthermore, high levels of inequality have been shown to impede growth in poor countries.[421]

Fostering the conditions for inclusive growth

Countries with favourable initial conditions – strong agricultural development and infrastructure, coupled with quality of governance and institutions – often have greater success at reducing poverty through economic growth. DFID's stated approach[422] to working regionally to reduce the costs of trading in developing countries is, therefore, an important measure that compliments private investment.

Low levels of spending on health and education in low-income countries can prevent the poor from accessing the opportunities brought about by economic growth. Changes in the provision of essential services and public goods remain equally or more effective than a single-minded focus on growth; this is especially true in poorer countries.[423] ODA which is focused on poverty reduction should therefore be seen as complementary to private investment in developing countries. Improvements in healthcare and education must be matched by increased access to resources to ensure that these improvements are supported by sustained and inclusive growth.

Smart investments

Growth in labour-intensive sectors of the economy that employ the most poor people – such as agriculture, small enterprises and industry – has a greater impact on poverty than growth in other sectors.[424] Greater equality of opportunity should be coupled with other measures, such as progressive taxation or cash transfers, to ensure inclusive growth - as the Brazilian case demonstrates.[425] Facilitating access to credit to encourage production and small enterprises is also essential to helping poor households participate in the market.

We welcome the new commitment by CDC to "avoid sectors that are already attracting capital from commercial investors", and to "explore difficult investment opportunities promising the greatest potential development returns in frontier places," including with greater financial risk.[426] The investments made by CDC, the DFID-owned fund management company, should be seen as complementary to private investment (particularly if undertaken according to the guiding principle of poverty reduction). These investments take on a burden of risk which has the potential to bolster nascent and more 'risky' markets. Donors must ensure, however, that public finance – where routed through traditional ODA or the CDC -

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420 E. Stuart, Making growth inclusive: Some lessons from countries and the literature, April 2011

421 H. Jones, Equity in Development: Why it is important and how to achieve it, Working Paper 311, Overseas Development Institute, 2009

422 DFID, May 2011, The Engine of Development: The private sector and prosperity for poor people, http://www.dfid.gov.uk/Documents/publications1/Private-sector-approach-paper-May2011.pdf

423 R. Gottschalk, P. Martins and S. Hague, Pro-poor Growth: The evidence beyond income, presented at the ESRC Development Economics Conference, September 2008

424 According to the Food and Agriculture Organization of the UN (FAO), GDP growth originating in agriculture, and particularly among smallholders, is on average at least twice as effective in benefiting the poorest half of a countries' population. See: FAO, 2009, Issues Briefs: How to Feed the World in 2050

425 Ibid.

426 CDC Group, May 2011, High Level Business Plan, http://www.cdcgroup.com/uploads/businessplanpresentation-may2011.pdf (accessed June 2011)

used to support private sector is not diverted from financing public and non-profit sector investments (e.g. in healthcare).

What are the prospects for using aid to support market-based initiatives, for example in providing insurance against earthquake damage?

Save the Children believes that ODA should ideally be channelled through the state system, rather than channelled into private sector investments. However, we view CDC as the legitimate mechanism through which DFID is able to support market-based initiatives. As such, we will focus our response to this question on the recent CDC reforms,[427] although the recommendations are intended to be applicable to other development finance institutions (DFIs), the socially responsible investment community, and, to a certain extent, all development-focussed market-based initiatives.

CDC's new approach

CDC's new Investment Policy commits it to investing in low and lower middle income countries in sub-Saharan Africa and South Asia. [428] Of the 46 sub-Saharan African and South Asian countries that CDC has earmarked[429] as potential investee countries, on average 12% of children do not survive until their fifth birthday - compared to a global under-five mortality rate which is just 6%.[430] These are the countries where 70% of the world's poor live, on less than US$1.25 a day.[431] A child born today in Angola, for example, is 37 times less likely to reach their fifth birthday than a child in the European Union.[432]

This focus on countries with the greatest need is vital; in particular, a commitment to invest in those sectors which will have the greatest impact on poverty reduction. With development impact as the priority, investments must also be guided by the strongest possible environmental, social and governance standards, with financial return a tertiary consideration.

The importance of ex-ante assessments

Poverty and social impact assessments must be made before, during and after any investment. Assessments must be consultative, including with the intended beneficiaries and affected populations, and including children where relevant. This increases accountability and transparency, both within the beneficiary community and with the UK public. Sectors with dubious developmental impact, or companies which are domiciled in tax havens,[433] should be excluded from investment. Recent research[434] reaffirms that CDC does not adequately

[427] The funding of public-private partnerships have not been considered in this response

[428] This is a welcome commitment, particularly in the context that only 0.6% of the UK's trade in goods is with Low Income Countries (predominantly with Bangladesh, Kenya and Ghana), which is indicative of a general lack of investment in the poorest countries (with the exception of the extractive sector). Reference: Department for Business, Innovation and Skills, February 2011, Trade and Investment for Growth, http://www.bis.gov.uk/assets/biscore/international-trade-investment-and-development/docs/t/11-717-trade-investment-for-growth.pdf

[429] CDC Group, May 2011, High Level Business Plan, http://www.cdcgroup.com/uploads/businessplanpresentation-may2011.pdf (accessed June 2011)

[430] Calculations based on UNICEF's State of the World's Children report, http://www.unicef.org/sowc2011/

[431] CDC Group, May 2011, High Level Business Plan, http://www.cdcgroup.com/uploads/businessplanpresentation-may2011.pdf (accessed June 2011)

[432] Save the Children, 2011, No Child Born to Die: Closing the Gaps, http://www.savethechildren.org.uk/en/docs/No_Child_Born_to_Die_low_res.pdf

[433] We welcome CDC's commitment to be transparent in its dealings from a tax perspective and would hope that an organisation supported by public funds would take a leading role in demonstrating tax transparency and accountability in practice.

[434] Norwegian Church Aid, May 2011, Investing in private sector development: what are the returns? http://www.eurodad.org/uploadedFiles/Whats_New/Reports/NCA_report_investing_in_private_sector_development.pdf

assess the development impacts of a potential investment during its initial appraisal. However, it has committed to "have established a methodology to assess the development potential of each investment during the appraisal stage."[435]

Assessment indicators

The new assessment methodology must be redesigned in ways that put poverty reduction at its heart, with particular attention being paid to the 'economic' and environmental, social and governance (ESG) performance indicators. The primary measurement for 'economic' performance, for example, is gross employment creation. However, gross employment figures mask variations in the quality of employment (trade union representation, health and safety conditions, working hours and wage levels etc) and do not count job 'displacement' from other businesses (i.e. whether 'new' jobs are offset by jobs lost or displaced from competitor companies[436]). ESG performance indicators should more explicitly reference human rights standards, with human rights due diligence being one aspect which informs investments.[437]

How does and how should development assistance engage with security concerns at a global level and at the level of individual (fragile) states?

The importance of aid in fragile states

Many of the poorest and neediest people live in conflict affected and fragile states. Children are the most vulnerable in conflict-affected fragile states. They are likely to miss out on the opportunity to go to school or progress beyond primary education; they face malnutrition which can stunt their mental and physical development; and they risk separation from their families, not to mention being traumatised by witnessing or being subjected to violence. Providing aid in conflict-affected and fragile states is essential if we are to give hope for the future to new generations. As such, it is vitally important that aid is invested in these countries, and that a significant proportion of this aid is directed towards addressing the needs of children.

Security concerns should not trump need

Aid risks being security-driven if specific areas of fragile states where there is substantial humanitarian need are neglected in favour of other areas that are affected by conflict (e.g. central vs. eastern DRC; South Sudan vs. Darfur; Afghanistan[438]). Such a means of prioritising aid not only potentially contravenes a rights-based approach that prioritises those most in need of support; it is also a short-termist approach to stability.

Aid quality

The quality of the aid provided is just, if not more, important than the quantity of support, as irregular or poorly directed aid can exacerbate instability. This means providing predictable, long term funding, both to countries that have emerged from conflict and those countries that are struggling to prevent an escalation of conflict.

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435 CDC Group, May 2011, High Level Business Plan, http://www.cdcgroup.com/uploads/businessplanpresentation-may2011.pdf

436 Norwegian Church Aid, May 2011, Investing in private sector development: what are the returns?, p. 26, http://www.eurodad.org/uploadedFiles/Whats_New/Reports/NCA_report_investing_in_private_sector_development.pdf

437 Save the Children, November 2010, Inquiry into the future of CDC: Submission by Save the Children UK to the International Development Select Committee

438 ODI (2011) 'Security, humanitarian action and development: navigating a shared space for international engagement in fragile states', p.3

Conclusions and recommendations
The impact of development aid - on economic growth and on the development of recipient countries more generally – will continue to be hotly debated, and any position difficult to prove beyond all questioning. However, there is evidence that aid, given in the right way and to the right sectors, coupled with helpful institutions, capacity building and responsible donor practice and complementary to private sector investment, can have significant positive effects on the countries to which it is given. It is no, in itself, enough to end poverty; but neither is economic growth on its own a panacea for the challenges presented by poverty. Aid can both help to catalyse economic growth in ways that help the poorest and most marginalised people in society access its benefits.

The following recommendations can help to maximise the impact and effectiveness of development aid:

Invest in social sectors: Targeting aid at sectors such as education, nutrition and healthcare can have long term positive impacts on the future economic growth of a country, by increasing its human capital.

Align aid with national development priorities, including the use of budget support: Budget support reduces the transaction costs of aid, avoiding the fragmentation and scattershot focus of project based aid; it also allows countries to marshal their resources most effectively towards the development targets and sectors that are most important to them at their particular stage of development.

Focus aid on children and young people: Children and young people make up a huge proportion of the population in poor countries. Investing in them early on can help to bolster their ability to contribute to their countries' development in adulthood.

Investments should be guided by development impact: encourage inclusive investment in sectors and companies which are likely to have the greatest impact on poverty reduction. CDC should show leadership in this area, demonstrating that development impacts guide decisions before, during and after investments

Follow best practice in giving aid to fragile states: Donors should resist the temptation to unduly concentrate aid in conflict affected regions.

Additional Recommended Reading:

Children and Economic Growth (2010):
http://www.savethechildren.org.uk/en/docs/Children_Growth.pdf

The Economic Crisis: Balancing the books on the backs of the world's most vulnerable children? (2010):
http://www.savethechildren.org.uk/en/docs/Economic_Crisis_G20_Briefing.pdf

The least developed countries - biggest challenges, least assistance? (2011):
http://www.savethechildren.org.uk/en/54_15527.htm

Fragile States (2011): http://www.savethechildren.org.uk/en/54_12535.htm

UK Development Aid: Challenges and Choices (2010):
http://www.savethechildren.org.uk/en/54_11084.htm

Investing in Children's Nutrition – The Economic Benefits (2010):
http://www.savethechildren.org.uk/en/docs/Investing_in_childrens_nutrition_policy_brief_(2).pdf

June 2011

Save the Children, Practical Action, Christian Aid and Oxfam—Oral evidence (QQ 206-251)

Transcript to be found under Practical Action

Save the Children—Supplementary written evidence

Note: Implementing partners and transparency*

Save the Children operates in some of the most challenging operating environments on earth, reaching the poorest and most vulnerable children and their families. The balance between the need and the risk associated with working in the most fragile and conflict-affected states is one that Save the Children tries to strike as best we can, however our priority will always be to reach those who need our help the most.

We are dedicated to ensuring that all resources allocated to beneficiaries get to those who need assistance. We have vigorous vetting procedures for potential partners and do not work with any entity – governing body or CSO partner, with links to terrorist activity. Each potential partner is assessed against an international register of terrorist groupings before we proceed with a partnership. Save the Children takes issues of Fraud, Bribery and Corruption very seriously and has rigorous policies and procedures in place to ensure that our funds reach our intended beneficiaries. We have launched an Anti-Bribery and Corruption Policy which complies with the UK Anti Bribery act which came into force in July 2011. Each of these policies is applied to staff members, consultants, trustees, contractors and other partners.

We have comprehensive procurement policies that every country programme is required to follow. These are designed in part to prevent fraud and corruption taking place. To complement these policies we have a robust internal reporting mechanism for reporting fraud and corruption including a whistle blowing policy that is independent of line management through which staff and beneficiaries can register financial (or other) concerns, and a strong Internal Audit team who regularly visit and review our country programmes. We treat suspicions of fraud and corruption as seriously as actual fraud even where it is not for personal gain.

Based on the fact that we have such rigorous policies and procedures in place to mitigate against the diversion of resources from beneficiaries, incidences of Save the Children withdrawing financial support to partners in-country are relatively rare. However, as soon as an incidence arises, we are quick to take action. Several examples from one region of operation in Africa follow.

In West and Central Africa, a supplier who was participating in an open tendering process to provide a service to Save the Children, offered a cash bribe to one of the staff dealing with the tender. The staff member refused the bribe and reported to his line manager. Immediate action was taken to debar the supplier from the process. Legal action is being taken against the supplier.

In West and Central Africa, a local partner was found to have diverted funds away from beneficiaries. Save the Children immediately ceased its partnership and took steps to arrange alternative arrangements for providing care and support. A complaint has been made to the local police, and investigations are ongoing.

In an instance of suspected collusion between partner organisations implementing a project and current and former staff members in West and Central Africa, collaborators attempted to divert funds away from beneficiaries. In this instance, proceedings were taken against finance staff on grounds of negligence, as well as against suspected staff members. While investigations into partners are pending, all contracts between them and Save the Children have been suspended.

As soon as a case of impropriety or a diversion of funds is suspected in a country programme, we review all our processes in country to see if they can be improved and learn lessons across countries. All cases of fraud, theft, bribery and corruption are recorded on a fraud register held centrally at HQ and cases can only be closed by the Audit Committee when they are satisfied with the steps taken re investigation and outcome of each incident. We always report cases to the Charity Commission in line with their guidelines and work with them to ensure they are happy with the steps we have taken to resolve the situation.

9 January 2011

*For the purposes of this note, we have not provided names of implementing partners, or Countries in question. We have done this in order to protect our presence in-country, our reputation and that of our implementing partners

Rt Hon Rory Stewart MP—Oral evidence (QQ 338-364)

Evidence Session No. 10. *Heard in Public.* *Questions 338 - 364*

TUESDAY 8 NOVEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Lord Hollick
Baroness Kingsmill
Lord Lawson of Blaby
Lord Levene of Portsoken
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witness

Rory Stewart MP

Q338 The Chairman: Good afternoon. Thank you very much for coming and welcome to this House of Lords Select Committee. I ought to give a warning that we may have some votes this afternoon—I do not know whether you will have them—in the next hour or so. You will have to forgive us if we all have to dash off quickly and vote. I hope that that is all right from your point of view. This is the 10th public hearing of our inquiry into the impact and effectiveness of development aid. We are particularly keen to talk to you because, as you know, an increasing proportion of DfID aid is now intended to go to fragile states and post-conflict situations. This is what we want to focus on in this afternoon's session with you and have the benefit of your experience—some of us have seen your very lengthy and very good *Guardian* article—in that context. We fully recognise that different lessons may well apply to different conflict situations and fragile states. But given that—no doubt we will come on to that in due course—could we start by asking you to outline briefly the key lessons that you see from your own experience? Specifically, to what extent can aid support stability and economic growth in post-conflict situations?

Rory Stewart: I think the central lesson from Afghanistan is that we did best in the early days at providing access to education and health and providing basic infrastructure such as road construction, and we did worst at the grander objectives of state building, civil society and governance, so that from 2002 to 2004 broadly speaking we end up with 2 million more girls in school and with access to health clinics going up to about 85%. We also have a central bank and a stable currency, but the other objectives identified by DfID and others as being necessary elements of stability in Afghanistan, in particular two—the creation of a legitimate, effective, credible Afghan Government and the victory of a counter-insurgency campaign against the Taliban—proved to be largely unachievable.

I think that there is a reason for this. I do not think that it is an accident. The analysis in 2004 and 2005 is that the reason why we failed to make progress on these much grander objectives of governance and civil society was that we had not dedicated enough resources to them. One of the driving motivations for the deployment of British troops into Helmand in 2005, and the increase from 300 American soldiers in Helmand to 3,000 British troops, to 5,000, to 7,000, to 9,000, to now 32,000 American and British troops in that province, was governance, economic development and security, not in the sense of security against the Taliban but generic road security and counternarcotics—in other words, the sorts of objectives that DfID championed. It failed. My conclusion is that the problem was not resources. The problem was not that we lacked a strategy or a mission or that we lacked enough troops or lacked enough money. The problem was not the famous light footprint that everybody complained about in 2002, 2003 and 2004. The problem was that we are not capable of doing these things.

Our own institutions are unsuited to this kind of activity. We lack knowledge, power and legitimacy. We live extremely isolated lives in guarded compounds. Almost no British civilians or soldiers have ever spent a single night in an Afghan house. At the beginning of last year in our embassy in Kabul there were three officers who could speak Dari at an operational level and nobody who could speak Pashto out of 350 staff in that embassy. We are obsessed with increasingly abstract management consultancy jargon. That combination of abstraction, isolation and a form of unscrupulous optimism dooms those kinds of projects to failure.

Q339 The Chairman: Where does the aid issue fit in in that scenario?

Rory Stewart: It means that DfID, which is, of course, one of the major donors in Afghanistan, needs to differentiate between what it believes is necessary—in other words, it believes it is necessary for stability in Afghanistan to create a legitimate, effective and credible state—and what is possible. It may be that something is necessary for stability in Afghanistan but that may not be something which is within the gift of the British Government or our development agency to deliver. It needs to re-evaluate the entire state-building theory that it implemented, and which it supported from the end of 2001 and the beginning of 2002, and then with increasing aggression from 2005 onwards. It needs to reconsider its contribution to the Berlin conference of 2004 and it needs to reconsider the interim Afghan national development strategy. It needs to reconsider the 10 functions of a state that it signed up to and it needs to acknowledge that the most successful parts of its programme were probably those that supported things such as education, health, a stable currency and infrastructure, which may be less fashionable and may seem less central to the goal of stability.

Q340 Lord Lawson of Blaby: In shorthand terms, are you saying—this is something that I have always believed—that Robert Cooperism is a blind alley?

Rory Stewart: Yes, in shorthand terms, the liberal imperialist idea the fashion of creating governance and stability in a post-conflict zone through the application of development aid—is mistaken.

Q341 Lord Tugendhat: You have given a very comprehensive answer, which in a sense renders quite a number of other questions almost superfluous, but I shall none the less try. In his evidence to this inquiry, Professor Paul Collier argued that the biggest mistake that aid donors make is to seek to do too much with their aid in too short a time. He put it rather vividly by saying that "donors have tried to turn Afghanistan into Denmark in two years". I thought that your article in the *Guardian* went along with that. In the light of Professor Collier's remarks and in the light of what you have just said in your first answer, what do you think the objective of donors should be and what can they realistically seek to do?

Rory Stewart: Objectives should be very context specific, so a donor's objective in Afghanistan should be quite different from their objective in, for example, Bosnia. There are situations, and Bosnia is one of them, where it would be appropriate to have objectives such as the return of refugees, war crimes trials, the disarmament of the military and the abolition of internal borders. Those were things that we achieved in Bosnia but which we would have been unlikely to achieve in Afghanistan, so the context is central to this. You can set quite ambitious targets in the Bosnian context in which the politics is right. When the politics is wrong and when you lack consent, the problem is not so much that we tried to do too much in too short a period of time, as Professor Collier suggests. I would say that Professor Collier may be implying—I do not know whether he is—that it would be possible to transform the Afghan state if one were a little more patient. I think that even that is probably a little bit misleading. I think the gap between the capacity of the international community and the problems on the ground in Afghanistan was so severe, and the lack of consent and the mistrust among the Afghan population were almost so inevitable, that it would have been better for the British Government, the American Government and other international donors to focus on three very modest aims, which are supported by development activity.

One of them might be ensuring that al-Qaeda was not able significantly to enhance its ability to harm the United Kingdom, the United States or Europe from Afghan soil. A second might be to increase the chances of a political settlement and decrease the chances of a civil war. The third would be to continue to invest in the kinds of development projects with which we have a track record of success. They range from the national solidarity programme that was run in Afghan villages, which extended eventually to over 10,000 Afghan villages, essentially giving money to an elected village shura to do its own micro-development projects, through to education, health and investment in the stable areas—the north and the centre of Afghanistan, where the consent was there. There were many things that worked. There are many good NGOs on the ground. Oxfam, Save the Children, Care and Mercy Corps have been operating there for two or three decades. They have good Afghan staff and they understand the rural culture well. Intelligent co-operation with those NGOs would have achieved something. I am afraid that what happened, however, is that we became mesmerised by the technocratic fantasies of a centralised Afghan state.

Q342 Lord Smith of Clifton: I think that you have covered our questions, as Lord Tugendhat said, in your very trenchant opening statement and subsequent reply. The Government's recently published *Building Stability Overseas Strategy* sees development assistance playing a central role in the UK's investment in "upstream conflict prevention". One pillar of this engagement is using aid to rebuild critical institutions. Do we know what these institutions are and, importantly, how to build such institutions from the outside, with or without foreign aid? I think that I know your answer.

Rory Stewart: Yes, of course you know my answer. The only caveat that I would add is that there seems to have been some success in Bosnia and Kosovo in working with certain kinds of institution. The support of the Office of the High Representative to the refugee return process and the ministries in the Bosnian Government associated with refugee return was relatively successful. The support to the customs department in Bosnia was relatively successful. In Bosnia, they have managed to reduce the number of men under arms from 440,000 down to approximately 5,000 since 1995. I do not want to create a global pessimism that says that this stuff is not possible—

Lord Smith of Clifton: Go on.

Rory Stewart: So that is my caveat. Some things have been achieved in certain situations where we have had a reasonably positive environment. At the other extreme, Afghanistan shows where this does not work. Let us take one important example of institution building in Afghanistan, which is the whole area of rule of law and justice. An enormous amount of money—I would imagine considerably more than $1 billion—has been invested by the international coalition in trying to develop the institutions connected with the rule of law. In particular, that has involved building prisons, training judges—for example, flying them to Kansas for long seminars—bringing the Supreme Court of Afghanistan to give seminars at Harvard and printing legal codes. It has involved the training of police—huge amounts of money. At the moment the US and its allies, are spending about US$12.5 billion a year training the Afghan National Army and police. To put that in context, the entire annual revenue of the Afghan Government is approximately $1 billion, so we are spending nearly 12 times the entire annual revenue of the Afghan Government—

Lord Lawson of Blaby: "We" being?

Rory Stewart: The United States and its major allies, of which Britain is a major contributor. But it is predominantly American money. So an enormous effort is going in to trying to build up what has been identified, as you say, as the central institution—in this case, the institutions around the rule of law and justice.

The reality at the end of 10 years of investment is that 85% of Afghans continue to completely avoid the formal justice system. They will go to a meeting in a village where most of the institutions of which we are speaking are not present. There will not be, generally, a policeman to arrest them. They will be brought to trial—if, indeed, you can call it a trial—by other people in the village. The person presiding is probably their relative. The jury consists of other white beards in the community. There is usually no prison involved. Rather than there being a uniform legal code, there will be some medley of Sharia law and tribal custom. The only reason why you would normally go to a judge is if you wanted a passport or if you had the money to bribe the judge to make a decision in your favour. The Taliban continue in southern and eastern Afghanistan consistently to deliver justice under trees, which many people in the community consider more reliable and more rapid than the justice delivered by the formal institutions of the Afghan state.

It is a story of an enormous amount of investment and energy and it includes rule-of-law consultants coming from the United States. I was talking to one of them who had calculated that he and the other consultant were costing the US Government US$1.5 million if you took into account their security team, which was necessary to move them around, and their accommodation. I went to one of the seminars that they were giving. It appeared to me to consist of 150 of the most corrupt men in Afghanistan sitting in a room, with him sitting up at the head of the room delivering an anti-corruption seminar, in which he said, "You must commit to transparent, predictable and accountable financial processes." Everybody in the room was nodding and saying, "Transparent, predictable and accountable financial processes." The point that I am making, slightly facetiously, is that the institutions that surround a concept as grand as the rule of law are so deeply embedded in a specific society, a particular culture and a particular mode of operation that it is extremely implausible that international assistance would be able to do more than have a minimal or marginal impact, I suppose, on the efficacy of those institutions.

Q343 Baroness Kingsmill: Are you suggesting therefore that we should not have this sort of development aid provided via Government to Government? What are you suggesting?

Rory Stewart: No, I would like to see a situation in which we got away from the abstractions of believing that we had a universal mission of rule of law and governance to a situation where we were more liable to say, "This is what we can do in Bosnia but this is what we don't really believe works very well in Afghanistan." That begins with an institutional change in international development agencies, including DfID, where one would need people with serious area expertise and linguistic expertise who were able to judge the particular cultural and local context of the country. We need to become more and more suspicious of abstract, theoretical frameworks that attempt to have a global application. I would like to delegate more money down to the DfID country director and allow them to determine their own spending, rather than controlling it from London, so that they could think, "Oxfam seems to be doing a good job in Bamyan province in Afghanistan and I can see that £4 million or £5 million behind its existing programme would create a good impact." I suppose that I would like to move away from a grand, heavily funded universal system towards one that recognises that what matters is cultural context and that what works in Bosnia does not necessarily work in Afghanistan. I am trying to get away from this lessons-learnt mania and the idea that there is some generic expert in post-conflict resolution or state building who can leap on a plane to Somalia and opine.

Q344 Lord Forsyth of Drumlean: Can I take you back, Rory, to this $12 billion, which I am still trying to digest? What is the source of that figure?[439] How is it possible to spend $12 billion in such a way? Where is the money going?

Rory Stewart: It goes largely in trying to ensure that approximately 150,000 Afghan soldiers and policemen are put through training programmes to deal with an attrition rate that in 2010 was running at about 3% a month. That means that about 3% of the Afghan forces disappear in a given month, so every year that is obviously about 36% of your army and police force who are walking away. The training is provided predominantly by American and British soldiers, supplemented to some extent by policemen who are brought in as security contractors to teach. The scale of the challenge, just to try to illustrate this—

[439] The source for $12.5 billion a year for army and police training was direct from General Caldwell so should be contained in the Congressional Budget. The $135 billion was calculated by a Harvard University project on the costs of the Iraq and Afghan Wars.

Lord Forsyth of Drumlean: Sorry. I may have got my mental arithmetic wrong, but that would work out at about £750,000 each.

Rory Stewart: I take your word for it. I am sure that your mental arithmetic is better than mine.

Lord Forsyth of Drumlean: It is a staggering amount. How can you spend that amount of money?

Rory Stewart: General Caldwell is spending it; he is drawing the money down. He is making that target of spending over $12 billion.

Lord Forsyth of Drumlean: Where can we find the source for these numbers?

Rory Stewart: General Caldwell is the American three-star general responsible for managing the programme and he has drawn the money down through federal funding. It is supplemented in Helmand province, for example, by police training delivered last year by the Argyll and Sutherland Highlanders.

The Chairman: How far back does this figure of $12 billion go? Is it over a number of years?

Rory Stewart: They started spending that amount of money probably two years ago, under General Petraeus.

Lord Moonie: Is it Caldwell who has just been sacked? One of them was sacked last week.

Rory Stewart: I have not followed it.

Lord Moonie: It is just one of those silly things that you spot as a footnote. It was he or somebody else.

Rory Stewart: I was not aware that General Caldwell had been sacked.

Q345 Lord Hollick: What reaction have you had from DfID when you have explained this to it?

Rory Stewart: I think from DfID's point of view this analysis pushes against its basic self-conception. I think that DfID sees itself as the elite of the development world. It believes that it has an incredibly well developed managerial process, the best research and powerful proven models. It finds it very uncomfortable to distinguish between what it feels it ought to do and what it can do. It might challenge me, for example, by asking "Are you saying that the rule of law does not matter?" Of course I am not saying that the rule of law does not matter; I am saying that the international community cannot create the rule of law in Afghanistan it is something that may emerge but it would have to be led largely by a domestic, indigenous Afghan process. DfID questions my idea that its isolation and lack of area or country expertise is a severe limit on its ability to operate. It also would say in its defence that more than 80% of the DfID funding goes through the central budget of the Afghan Government and is used to support things such as teacher training. It does not like the idea of devolving power down to its country directors, partly because it has cut the number of staff while increasing its budgets, which means that it wants to manage larger and larger contracts. It might not like the idea of people throwing, as it were, £5 million at an NGO project in Bamyan. It might prefer to do a £120 million vocational training framework contract with a provider. I suppose DfID thinks that I am a gloomy pessimist. They would basically say, "It is not that bad really. It is going much better than you think. All you do is grumble and point out problems." They would I imagine write me off as a naysayer.

Q346 Lord Lawson of Blaby: Your evidence is interesting, important and knowledgeable. If I understand you aright, what you are saying is that certainly as far as fragile states and post-conflict situations are concerned—we are largely talking about conflict situations, not post-conflict situations—each country has to be treated on its own merits with a knowledge of its language, culture and history, but instead of this the aid agencies have a master plan that they think should work everywhere although this is unproductive, may be even counterproductive and is certainly very expensive. Is that what you are saying? Is this true not merely of aid agencies in general—the multilateral agencies, USAID and all the rest of them—but also of DfID, which, as you say, likes to think of itself as a cut above the rest?

Rory Stewart: Yes, that is broadly speaking what I am saying; it is a good summary of what I am saying. A caveat, of course, is that DfID would respond by saying that I am exaggerating and that it is very aware of the differences between these countries. There would be a lot of jargon around context and understanding of society. It would commission research projects on the specific socioeconomic conditions in Afghanistan and would attempt to compensate for its theoretical understanding of the gap between a global theory and the specific context by trying to produce papers on the tribal structure of Helmand and this sort of thing. But fundamentally this is where I disagree with DfID and other development agencies. I think such research is simply playing round the edges. I do not think that that cultural awareness is the central drive. It does those things but they are not properly processed in a system and it does not define the culture of the organisation.

DfID has very few people in the organisation who are now deep country experts, who speak languages well and who are deeply absorbed in the specific country in which they are serving. The nature of their work confines them to the DfID compound, so that if you were running, let us say, a £76 million counternarcotics programme in Afghanistan out of the DfID office, you would not spend that much time actually looking at the project. You would spend most of your time in the office, dealing with the various things you do in the office from e-mails to managing your contracts and checking that your invoices and receipts are sorted out. I suppose that I am, broadly speaking, caricaturing, but it is important to try to make this as stark as possible because where you began is correct—the fundamental point about societies in conflict is almost by very definition that they are among the most diverse, fragmented and opaque societies in the world. The generic sort of Fukuyama *End of History* globalisation thing applies least of all to a society like Afghanistan or Somalia.

To conclude on this, if you take Afghanistan, I was on a plane flying back with a development worker from Kabul a few weeks ago. He asked me whether I thought that there would be a Facebook revolution in Afghanistan. The problem is that in the latest Helmand police intake that I attended, eight out of 100 people could write their name or recognise numbers up to 10 and there is no electricity between Herat and Kabul. The notion that you could have a Facebook revolution implies that people are able to read and write and have electricity and computers. There is a problem here, and there is a problem in our contemporary culture, which is that we are not really forcing some very brilliant young people to take on quite how alien and difficult other people's societies are. I sometimes think that the grander our ambitions and the more abstract they are, the more deeply pessimistic we somehow are in our heart of hearts. They set up these objectives of a gender sensitive, multi-ethnic, centralised state based on democracy, human rights and the rule of law but actually they do not have an enormously developed affection for or understanding of Afghan society to underlie that.

The Chairman: We have quite a lot of questions that we want to cover, but in the meantime we will have just two more on this matter from Lord Tugendhat and then Lord Levene.

Q347 Lord Tugendhat: Following on from what Lord Lawson said, can I put two things to you? One is that Afghanistan is different from almost any other country because it has 150 years' experience of foreign intervention and most of the places in which we intervene have not had that kind of experience, so it knows all about how to resist foreign intervention and how to find ways round it. Secondly, when I listened to what you were saying, I could not help thinking of Graham Greene's *The Quiet American.* The way in which you described the DfID people as being full of good intentions reminded me very much of the man in Graham Greene's *The Quiet American*.

Rory Stewart: The first point on Afghanistan is absolutely right. We also have limitations of knowledge, as we do not know much about these societies, and limitations of power, as we very rarely have the people, resources and contacts to operate levers of power in the way that we imagine we can. We also have a problem of legitimacy in Afghanistan and, of course, to some extent in Iraq and indeed throughout the Islamic world, which means that there is a perpetual danger that people will misinterpret a development programme as something that makes them feel that they have to fight for their country and Islam against a foreign military occupation.

I do not want to patronise DfID officials, which may be a danger of what I am doing at the moment. I think the way to view them is that they are very bright civil servants who care about their job and work very hard, but the bureaucratic structures within the organisation—the way in which you are promoted and assigned to postings and the things that are validated in the 10 or 11 hours of your working day—do not necessarily reflect deep absorption in rural communities in the developing world. It is a world that I am afraid sometimes has more in common with a think tank or a policy unit than it does with what I believe development is more about, particularly in a very poor, fragile, traumatised country, which is understanding a specific community, specific people and politics. Unfortunately, one of the primary problems, whether you are talking about Somalia, Iraq or Afghanistan, is that development is deeply political. Unless these people are deeply aware of the internal politics of particular communities and their relations, it is very difficult to do sustainable development.

Q348 Lord Levene of Portsoken: I am as fascinated and amazed by the numbers as Lord Forsyth was. If some $12.5 billion is being spent there over the period in an area where the GDP is about $1 billion—

Rory Stewart: I would say that that is the revenue of the Government; GDP is higher, but that is the taxation revenue of the Government.

Lord Levene of Portsoken: From what you were saying, the extent of literacy is about 10%. Then we hear talk of framework contracts. It is like a parallel universe. You have one group of people living in a very basic society, scraping along with a few modern add-ons and then this sort of monster comes from outside spending $12.5 billion on producing framework contracts. There is no connection between the two. I am afraid that it plays to all my prejudices that people are going in there, as you say, with the best of intentions to produce something that the people who live there—the natives on the ground—have no interest in at all. We, and even more so the Americans, are spending enormous amounts of money creating a structure that has no purpose, because there is no read-across from what these very well meaning civil servants want to do, and on which they are spending enormous amounts of money, and people on the ground who are trying to scratch an existence. Is this aid money achieving anything other than keeping all those international civil servants and other people who are involved in a job?

Rory Stewart: The answer is that it has made an enormous difference to primary education, particularly in Afghanistan. To go back to the beginning of my remarks, it is not that development aid has done nothing. DfID has put a lot of money into the Department for Education, which has meant that there are now 2.5 million more girls in school. Even in provinces such as Helmand there have been very significant and, I think, real increases in the number of school attendees. Healthcare has improved dramatically in Afghanistan. Sima, who worked in my office four years ago, had to go to Pakistan for her heart treatment. She can now get it from a hospital in Kabul. The roads to Mazar-i-Sharif are much better than they were. The number of people using mobile telephones has gone from zero to about 5 million. There have been developments in certain areas of agriculture and there has been a certain amount of urban regeneration.

All this international aid money is producing bizarre and startling figures on GDP growth. There was a claim last year that they were achieving GDP growth of almost 47%. This is, of course, almost all because that $12 billion is part of $135 billion a year, which is what the American Government estimate that they are spending in Afghanistan if you take into account their troop deployment. There is a huge amount of international money pouring into the country. Some of it is international aid money, there is a lot of drug money and a lot of this reappears in property booms. Somewhere along the edge, at the margin of this, Afghan society is improving in various ways, so Afghans are healthier and more educated than they were 10 years ago.

However, I think that your basic point that there is a surreal gap between the rhetoric of the international community and the reality holds. I have talked about rule of law and tried to disaggregate that and show why rule-of-law programmes do not really work. Eventually, I think that DfID has acknowledged this and the American Government have acknowledged this and they are now talking more about traditional justice and how you can invest in traditional justice. But it is a very belated acknowledgement and when they get there they discover that they cannot do much about traditional justice because if traditional justice comprises the white-bearded village chief sitting in a mud house with other white beards, doing what he has always done about somebody who has stolen a goat, it is not clear what the international community can contribute to that form of justice. I think that I could make the same argument on governance and civil society. It is not that we need to conclude that there is nothing that we can do, but we probably need to recognise that there are certain things we do best. There is an added benefit to those things, which is that they tend to be things that Afghans themselves are most interested in.

The Chairman: I think that we must move on, because we have a lot of other questions to come.

Q349 Lord Shipley: Might it be argued that building peace and development can best be achieved through increasing the number of jobs? Speaking generally about fragile states, is it possible to drive peace through the creation of jobs, and how do we best do that?

Rory Stewart: There are two separate questions. One is: do we know how to create jobs in other people's countries? The second is: does creating jobs lead to peace? The answer to the first question is that we know how to spend international aid money and to give international military assistance in a way that provides temporary employment but we do not seem generally to have found the secret recipe for creating jobs in other people's countries, or, indeed, always in our own country. Creating sustainable businesses in a country like Afghanistan is very difficult because material costs are high and labour costs are very high. We have created rampant inflation so that the average worker in Kabul expects to earn over $5 a day at a time when their competitors in India and China would be on about $2 a day. The transport costs are also very high, so we have not succeeded in creating sustainable businesses. Most of the jobs that we create are very dependent on the continuing inflows of short-term international money.

As to whether that contributes to peace and security, that is also questionable. Some rather good research by Andrew Wilder at Tufts University suggests that a lot of our economic projects in Afghanistan increase instability rather than decrease it because they tend to create jobs in one village but not in another and that creates tensions and rage between one community and another, who say, "Why have they got the bridge, the clinic and the jobs and we haven't?" It was certainly my experience in Iraq that there was no direct relationship between the wealthy areas of the country and the peaceful areas of the country. In fact, in Afghanistan some of the poorest areas of the country such as Bamyan and the whole Hazarajat are relatively peaceful. We spent more in 2008 on the single sub-district of Panjwaye, south of Kandahar, than we did in the entire province of Bamyan, yet Bamyan has 3 million people and is far more peaceful. Therefore, I would say that both those things are open to question. Obviously, I defer to people like Lord Lawson on the question of whether there is a silver bullet out there which allows us to create sustainable economic growth in somebody else's country, but we certainly do not seem to be finding that silver bullet much. I am convinced by Andrew's argument that often the economic growth that we create creates more insecurity rather than less.

Q350 Lord Shipley: You mentioned Iraq. We heard from an earlier witness from DfID that the Basra Investment Commission was an example of a successful aid intervention aimed at creating jobs. How effective was it in your view?

Rory Stewart: I am not an expert on the Basra Investment Commission so I am not able to talk about that, but I can assure you that the work that was done in Al Amarah and Nasiriyah between August 2003 and the beginning of July 2004 created to my mind nothing in the way of sustainable employment. That is not a criticism of DfID, as this was not primarily driven by DfID. It was primarily driven by other bits—consultants, contractors, Foreign Office personnel and US army personnel. Let me take the projects that we did. We did a project that involved employing 3,500 people to clear garbage. So long as we had the money to pay them, which was for a couple of months, we had 3,500 people clearing garbage. We set up a vocational training school, which was terrific, but there was no stable income stream for it. I suppose that that created some skilled carpenters. We refurbished a grain silo and the refinery fuel pumps and we bought a few more fuel trucks. We looked at building a gas-powered generator and we did some road projects. We repaired some schools and some clinics and we tried to do stuff in support of a fruit business. But none of the stuff that I saw done in Amarah or Nasiriyah over that 11-month period was anything resembling sustainable employment.

Q351 Baroness Kingsmill: Corruption and the misappropriation of funds seem to be endemic in post-conflict environments and fragile states. It is there but the aid agencies say that they should have zero tolerance of such things. How do you reconcile the reality with the appropriate commitment to seeing that there should not be such corruption? How do you reconcile that?

Rory Stewart: I think that the major international non-profits have been relatively good at avoiding getting into corrupt relationships with people. It appears to be possible for Oxfam or Save the Children to deliver development aid to communities without paying huge numbers of bribes. In fact, one of the nice things about operating in most of the developing world is that most Governments in the developing world seem to be relatively good about not shaking down NGOs for bribes. The problem with corruption emerges not so much in the delivery of development assistance but in the justice sector and in business. One of the problems of setting up a business in Afghanistan is that it seems to be almost impossible to get a contract without paying a bribe. It is very difficult to run a tender process. The same is true in Libya. I do not think that DfID money is generally being stolen. But corruption is very difficult.

We have seen the most amazing things in Afghanistan. Part of it is overcharging, so, for example, the *New York Times* discovered four years ago that the average cost of a USAID secondary school in Afghanistan was $135,000, when in fact the school cost about $40,000 to build. What has happened to the intervening money is that USAID has contracted with a beltway contractor in the United States, who has subcontracted to a local partner in Afghanistan, who has subcontracted to another local partner and so on. Probably the contractor at the bottom has charged $60,000 when it cost them $40,000 to put it up. That is the way in which a lot of the money goes. We found with a project financed by one of the most creditable multilateral donors that the Afghan contractor was removing the reinforcement rods from the cement as they built the project. Every metre, they would pull out the rod and stick it in the next patch so that when it was tested there was a rod in there.

Q352 Baroness Kingsmill: You have a lot of anecdotes of this kind. I am beginning to get the sense that you have a sort of "small is beautiful" approach to these things; you think that Governments do not handle them very well and would be better off handing the money over, with appropriate controls, to smaller on-the-ground organisations such as Oxfam who have spent many years there, and that that would be a better way of dealing with these fragile states. Is that about right?

Rory Stewart: Yes. But let me just very quickly point out that there is a problem with such an approach, which is that by doing that you create parallel processes and you undermine the credibility of the Afghan state. If you are an Afghan Minister, you are very reluctant to allow that to happen. You do not want Oxfam, Save the Children or CARE getting the credit for building these schools and clinics. You want people to say, "Thank goodness for the Afghan Government who are delivering this stuff." They try to get round it by saying, "The solution to that is that you bring in PricewaterhouseCoopers or Crown Agents or someone to manage your contracting and tendering process so you can give the money to the central budget of the Afghan Government and they can spend it on schools and it is done without corruption." In my experience, it is very rare for that to be achieved, which means that I fear we often have to fall back on credible, well established non-profits delivering. However, we have to understand that that is in a sense the lesser evil and that there is a terrible cost to doing it that way in terms of undermining the credibility of the central Government.

Q353 The Chairman: Have you some way of dealing with those problems?

Rory Stewart: Yes, I think that there is a way of dealing with it, which is that you might take a more pragmatic approach. You might give less money to the Afghan Government. One of the criticisms that I might make gently of DfID and other international donors who give their money to the Afghan Government is the following. I believe that from 2003 to 2008 the Afghan Government never succeeded in spending more than 30% of their development budget, yet every year we kept pumping in more and more money. One thing that one could do is put in less. The Afghan Government can responsibly manage smaller funds. There are better departments and worse departments and you might want to work with the better departments in the Government. But everybody is in too much of a hurry and there is too much money around. Huge international conferences are called and Finance Ministers demand eye-watering sums of assistance and promise that it can all be pumped through their central budget and they will deliver miracles.

Q354 Lord Forsyth of Drumlean: So where does it go? Where is it?

Rory Stewart: Most of it sits there unspent. It is just not spent. It sits in the bank accounts of the Afghan Government. The one thing that the international community did do was put in checks and balances to make sure that the Afghan Government could not spend the money unless they had proper proposals and proper audited processes. The Afghan Government never had the capacity to deliver those things, so they could never spend the money. I believe that the World Bank Kabul urban upgrading project had something like $120 million sitting waiting to be spent for about four years without them managing to spend any of it except for minor sums on consultancy.

Lord Forsyth of Drumlean: So there is a huge cash surplus sitting somewhere in Afghanistan.

Rory Stewart: Yes, there has consistently been a huge cash surplus in Afghanistan.

Lord Forsyth of Drumlean: Perhaps they could give it to the EU.

Q355 Lord Lipsey: You are relatively upbeat about what was being achieved through spending on health and education, but in a place such as the one that you describe how on earth can we know whether the money is being spent effectively or not?

Rory Stewart: The answer is that most of central and north Afghanistan is safe for a foreigner to travel in. The egregious abuse is very clear. You can turn up in many provinces in Afghanistan and see schools built in 2002 which are now abandoned or which have collapsed because they have been built from cheap concrete. That is what I am really worried about. I am not so worried about a school that is full of happy children and is still standing where we might have been charged 20% more than the actual price. What I am really worried about is total disaster. You can see all over Afghanistan good Turkish-built roads that do not have potholes in them and bad roads around Kabul that collapse within six months. You can see schools whose roofs are still on and others whose roofs are not. Afghans themselves are very focused on education and healthcare. Let me give an example from a very small NGO that I was running in Kabul. The striking difference between, for example, the playground that I had built, which I saw a month and a half ago was occupied by a drug addict, 15 chickens and a goat, and the clinic is that the Afghans believe in the clinic and therefore it is working.

The Chairman: I am sorry but we will have to stop for a Division. We will be back as soon as possible.

The Committee was suspended for a Division in the House.

On resuming—

Q356 Lord Hollick: Against the background of the comments that you have made about the misappropriation and misallocation of funds—and, frankly, the misdirection of policy—how do you feel about DfID's commitment to allocate 30% of British aid to fragile and post-conflict states by 2014-15? What changes, in your view, should they be making in their thinking and their approach? How would they go about convincing a very sceptical public that this is a proper use of taxpayers' funds, which of course are in rather short supply?

Rory Stewart: The major issue that DfID have to deal with in relation to post-conflict and fragile states is that the conventional economic models in development with which they operate—I think that they are aware of this—are difficult to apply in situations where what really matters are politics and often violence. Whatever levers you think you are pulling in the economy, they are difficult to apply in a situation in which there might be armed groups, in which the country might be supplying 93% of the world's heroin, in which the central Government's writ does not extend more than a couple of miles beyond the capital and in which you have next to no economic data from which to operate. In Kosovo, for example, which is a relatively developed, settled and stable place compared to a lot of these other countries, we discovered that the international community had overestimated the size of Pristina twofold—they had doubled the population of the capital city and had not noticed for three years because the data collection was so poor. I think that these are all things that DfID is probably aware of. If you were to challenge a DfID economist with this, they would have to accept it.

So then the question is: what do we make of putting 30% of our funding into these areas? The first thing to say is that I am obviously more comfortable in relation to a country like Afghanistan spending money on humanitarian projects than I am on continuing to conduct a counter-insurgency campaign. I think that there is a stronger argument for us having some form of moral or humanitarian obligation towards the Afghan people. If it is possible for us to deliver that education and health and to help to make Afghanistan a more stable, prosperous and humane society in 30 years' time than it is today, that is a good thing. The sums of money that DfID are likely to spend are likely to be very small compared to the sums of money that our militaries spend in these situations. I think, though, that that spending needs to be honest in its objectives. We should not make too many instrumental claims. We should not suggest that the expenditure that we are bringing is necessarily going to contribute to stability. It may be more honest to say that we are spending money because we would like some more girls to go to school—full stop—without making any great claims about what that might or might not mean for warring factions, terrorism or regional instability. I think that you could make a decent case to the British people about why you might want to help girls to go to school in Afghanistan. I think that the problem comes when you try to make grand arguments about national security, because it is quite possible that you could allow more girls to go to school in Afghanistan without dramatically improving Britain's national security.

Q357 Lord Hollick: You made the point earlier that a large amount of funding—I think that you said 70%—was not actually spent. What is the point of allotting such a very large proportion of the budget to countries that cannot actually spend it? My second question is whether there is anything in the experience in Kosovo or Sierra Leone that has informed this approach and made us more confident that this is the right way forward. What are the antecedents to this approach?

Rory Stewart: On the first point, very bluntly, I agree with you. There is not much point in giving an enormous amount of money that is not spent. The antecedents question is very interesting. The answer is, of course, that the whole Robert Cooper issue of precedents and antecedents, which Lord Lawson raised, is at the heart of all this. The lessons that were learnt from Bosnia and which informed the conventional wisdom were that what you needed to do was—basically this is the vision of Paddy Ashdown—to go in hard, establish the rule of law, establish security, establish good governance and delay things like elections until those things were in place. The conclusions that we took from Bosnia were that what was required were heroic nation builders—people who threw the force of their personality and will to bend the recalcitrant public and to create the foundations of the new state. It is slightly unfair to put this too much on Lord Ashdown's head, but that is broadly speaking the way in which I would read his conclusions from Bosnia. That was deeply influential on how not only DfID but the World Bank, the US Government and others think about what they should do in Afghanistan or Iraq.

The second school of thought that we took from Bosnia was broadly speaking a planning school, which was championed by the RAND Corporation in a book called *The Beginner's Guide to Nation-Building*. Their conclusion was that what you needed were a good plan and good resources—enormous resources. In fact, they claimed on the basis of a study of, I think, as many as 70 previous nation-building activities that the one factor that really mattered was the amount of money and the number of troops that you deployed. They even had charts in the back of *The Beginner's Guide to Nation-Building* suggesting that there is an exact mathematical formula: for a population of X you need X divided by 20 troops.

These are two wrong lessons, I believe. Yes, Bosnia, Kosovo and Sierra Leone have been very influential, but in the wrong way, because the real lessons from those societies are quite different. The actual success that we had in Bosnia came about, ironically, by doing none of the things that they would suggest we should do. The international forces were incredibly cautious in Bosnia in the early years. We tolerated war criminals such as Karadzic still continuing to participate in the political process two years after 1995. We were very slow at moving ahead with our reforms and objectives. Indeed, we began to do so only once Bosnian society itself began moving in that direction—we seized those opportunities and followed them up. The view of Lord Ashdown or the RAND Corporation, which somehow sees these operations as primarily a question of management and heroic will, as though they are a sort of military operation in which you need lots of cash, lots of resources and a great general, mistakes the nature of our success. Bosnia succeeded in essence because the regional situation began to change—eventually Tudjman disappears and Milosevic falls, internal moves within Republika Srpska lead to Karadzic's position being undermined and Bosnian NGOs begin pushing for refugee return. In the background, we have interesting institutions such as The Hague war crimes tribunal operating and we have young, enthusiastic people prepared to follow up on some of the opportunities presented, but the real lesson is that what mattered was political, particularly micro-politics. If we had taken that lesson to Afghanistan and Iraq, I think that we would have seen more clearly both the challenges that we faced and the solutions.

Q358 Lord Best: Do you think that the failures that you have enumerated in relation to DfID's aid programme would be greater or less if multinational agencies were used—the EU, the World Bank and the UN in its different forms? Would things be better in your experience if those agencies handled the aid?

Rory Stewart: My intuition on that is that generally, pound for pound, DfID probably performs better than those multilateral organisations. It is generally more inventive and flexible and imposes less onerous reporting requirements than those other organisations. The problem that most people find with accessing DfID funds is that it can be quite difficult to get them in the first place, but once you have got them DfID can be more flexible and imaginative than other donors in supporting a project on the ground. I think that DfID could do more to trust its local country directors. It could do more occasionally to invest in unfashionable projects. I think that DfID can follow fashion, so it can become obsessed for a period with, for example, governance, civil society and the rule of law or state building and turn away dramatically from infrastructure. Or it can become obsessed with, for example, the presence of gender mainstreaming in donor proposal writing. However, I think that these are questions of degree. I think that with DfID the key is to speak with the language of swinging a pendulum back, saying, "It is not that governance or supporting the Afghan Government or gender mainstreaming is not important, it is just that it is not the only thing; it is not the be-all and end-all." DfID perhaps needs to recover a little bit of stuff that it sometimes feels is a bit old-fashioned and fuddy-duddy.

Q359 Lord Best: As regards those things that you do not really approve of, such as the governance things and the rule of law things, is DfID particularly obsessed—if that is not the wrong word—with those issues compared with other agencies or has everybody across the piece been going for the wrong targets?

Rory Stewart: I think that it is across the piece. There is a reason for that, which is that DfID is a highly influential body. It is extremely thoughtful, produces a lot of policy papers and supports a lot of academics and think tanks. Consequently, it is not a coincidence that what DfID believes, the UN and other multilateral agencies tend to be saying 18 months or two years later. DfID is a highly credible, influential organisation. The broad world view of DfID is now broadly shared within the majority of major aid agencies, both bilateral and multilateral. The exceptions would be the Japanese. For example, the Japanese have built the airport in Kabul with big signs all over it saying, "Gift from the people of Japan". That type of development is not development that DfID supports or is very interested in. However, it may be worth looking at again because, of course, the Japanese get enormous brownie points from the Afghan people. Our best practice is so goody-goody that we often do not get much credit in Afghanistan because we are so keen to make sure that over 80% of our funding goes directly to the central budget of the Afghan Government, and the Afghan Government get the credit for doing these projects. You have a slightly paradoxical situation where the Japanese, the French and the Germans, who are spending tiny fractions of money compared with us, may be more visible in somewhere like Kabul because they are backing a highly prestigious elite French or German high school or they are building the airport into which you land, whereas quite a lot of what DfID might be doing in governance, capacity building and civil society may be good in and of itself but in terms of the quick, visible political impact in Afghan minds it may be a little more indirect and a little bit slower. It may win enormous popularity with other donors, set a high standard and impress Afghan government Ministers, but most of my Afghan staff would not be aware of DfID programmes in Kabul in the way that they would be aware of the programmes of smaller donors.

Q360 Lord Levene of Portsoken: A central tenet of DfID's general approach is that aid effectiveness is enhanced when reforms are locally owned and where DfID acts in partnership with Governments who share a broadly common view of development. Can this principle be embedded in this country's engagement with fragile and post-conflict states where the political legitimacy and developmental perspectives of those states may be somewhat fragile?

Rory Stewart: Lord Levene, that is a brilliant question because, of course, it is true: you cannot disagree with the statement that these changes work best when they are locally owned, but owned by whom? What happens often, particularly in Muslim states in the developing world, is that the governmental elite have a very grand technocratic vision of state building which usually involves the creation of a heavily centralised state. Culturally, in terms of their education and background, they may often be upper-middle-class people who have spent considerable periods of their lives in the United States and who have a suspicion of rural areas of their country, which they may see as backward, although they would not call them that. They may well feel that they are in a fight with the conservative forces of Islam and tribe. They may feel that they are the Ataturk of their nation. Then, if somebody comes to DfID and says, "These are the reforms we want. Give us the cash to support this," in one sense the project is locally owned because it happens to be championed by a particular Cabinet Minister, but it may have very little local legitimacy because it may have absolutely no connection with the 85% of the population who live in the rural areas.

Lord Levene of Portsoken: So he has no levers to pull, or if he pulls the levers there is nothing at the other end.

Rory Stewart: Yes. There could be three sorts of problems. The lever could be completely futile, and then nothing may happen; it could be dangerous; or it could even be counterproductive. In the case of Afghanistan, the thrust for a heavily centralised state in fact exacerbated the insurgency because it is a country of many different ethnic groups deeply suspicious of central government. Our attempt to reinforce the construction of a heavily centralised state alienated a large number of the population and created more problems than it solved. Again, it is all about politics. I keep coming back to this. The question is not a generic phrase such as, "Is it locally owned?" or "Is there local support?", but questions such as, "What are the specific politics of this country? What is the texture of this country? In which direction is it going?" These are not questions primarily for economists.

Q361 Lord Forsyth of Drumlean: We had some written evidence from Michela Wrong, who raised the question of where increasingly authoritarian leaders of weak states are heavily supported by the UK and other western donors and then use that to revamp their internal security systems in order to prevent political opposition. I suspect that she was probably thinking of countries such as Uganda, Ethiopia and perhaps Rwanda. Do you share those concerns?

Rory Stewart: Yes, absolutely, because as usual we tend to be riding two horses at once. One of them is the development horse and the other is the security horse. Often in a context such as Afghanistan, the real reason why we are spending so much money is that we are conducting a counter-insurgency campaign or we are worried about terrorists. Therefore, we are sort of supportive of democratisation and elections, but we are also trying to create an army and police which will number nearly 400,000 people. We are pumping far more money into the police and army, their training and equipping than into any other institution of the state. Why? Because, essentially, we are trying to maintain security and we broadly believe that the way to maintain security is to create something that is deeply authoritarian. The danger that we raise in Afghanistan is that we end up with a situation such as that in Pakistan, where the strongest, most credible institution of the state is the military, and we end up with something approaching a military coup.

This is one of the reasons why I am suspicious of state building as an agenda. State building, almost by its nature, involves betting on the existing incumbent Government. It is true that countries do not do well without functioning states, but there is an enormous moral hazard in us trying to determine the development of that state. I think in retrospect that the things we were most proud of in Afghanistan were not things connected with the creation of this authoritarian, centralised state but more traditional humanitarian projects of exactly the sort that we were conducting even during the civil war period and even during the Taliban period. The closer the development community gets to grand projects of security, state building, stabilisation and governance, the more tainted it becomes and the more liable the many opponents within that state are to turn round and see what is intended to be a generous humanitarian contribution as a form of covert imperialism.

Q362 Lord Moonie: As we have seen in Afghanistan and Iraq, much aid delivery in fragile environments is delegated to international agencies, specialist NGOs and possibly the private sector. Can organisations like that deliver effectively our increased aid commitment to fragile states? Do DfID and the other members of the Conflict Pool have the capacity to carry out due diligence on these organisations?

Rory Stewart: That is a very good question. It is probably the central question. I do not have an answer but I would say that the issues that you would need to look at are these. How many staff do they have managing the set amount of money? What size contracts are they trying to let? How many viable contractors exist in country? How many of those people actually have extensive local staff? What form of serious monitoring and support can they provide for these organisations? In the worst-case scenario, you would go into a country that has just come out of a war and where you have almost no foreign presence. You try to let contracts and of course lots of people will sign up to take those contracts from you. I have many friends who are making $1,500 or $2,000 a day as consultants in international development around the world. They will say to you, "Don't worry. Give me the contracts and I will deliver the political participation, the poor, the vulnerable and the marginalised, particularly women," or whatever it happens to be. They will say, "I'll deliver transparent, predictable and accountable financial processes for you." They will then have to scurry around and create a local organisation, which involves flying in, hiring translators, hiring drivers and hiring engineers, often stealing them from pre-existing local NGOs, and rapidly improvising a programme that may be on a relatively short timeframe, producing all your contracts, invoices and receipts. You do your final report and you are out. That is the worst-case scenario. The question to ask when we are going in is whether there is enough capacity on the ground to absorb this amount of money. If there is not, let us take our foot off the accelerator, look realistically at what is actually there and match our resources not just to our priorities but to our capacity.

Q363 The Chairman: How difficult is it to evaluate and differentiate between some of these organisations, especially the NGOs? Presumably there are a number of NGOs which have been on the ground and do not have the paraphernalia that you have been describing but which are doing a very thorough and solid job. Is it a difficult task to make that differentiation?

Rory Stewart: I do not believe that it is. It is surprisingly clear on the ground in somewhere like Afghanistan who is good and who is not. The DfID country director would be very aware of that. It does not require very elaborate metrical structures and monitoring and evaluation structures. The Aga Khan Development Network does a very good job in Afghanistan, as does Oxfam. Save the Children has been in Afghanistan for 30 years and does a good job. CARE has a very impressive director and does a very good job. Mercy Corps has done really good work in southern Afghanistan. These are not revelations for anybody in the humanitarian community in Afghanistan. The problem is that those organisations are relatively limited in their capacity. If you suddenly need to spend an additional $2.5 billion, you are then going to a beltway contractor and saying, "Can you take a $130 million framework contract for me for school building?" Suddenly you are moving into a different universe, in which people who specialise in that kind of process are drawn into the game. I think that that is where the trouble comes. The huge sums of money mean that necessarily those organisations have the expertise and the experience. What is the strength of Oxfam, Mercy Corps or Save the Children on the ground in Afghanistan? It is their Afghan staff. They have 350 or 400 Afghan engineers who have been working for 20 to 25 years in specific communities; they know those communities well and they know the head men well. They have installed the water supply themselves and tried to plant 100,000 trees 10 years ago, all of which died because they were not properly irrigated. Through these series of experiences of the vagaries of the international community, they are now pretty good at delivering programmes. The problem is that those people become a tiny minority once the civilian surge comes and over 10,000 foreigners turn up to absorb that money.

The Chairman: Lord Lawson, this is a question close to your heart.

Q364 Lord Lawson of Blaby: Yes, the problem of spending to good effect the very large sums of money in the hands of the aid agencies both bilateral, like DfID, and multilateral is very clear to us. We spoke earlier of the British Government's objective of devoting 30% of British aid to fragile and post-conflict states, although "post" is a slightly dubious qualification as regards many of them. But, of course, this is 30% of a sum that is scheduled to rise. Indeed, the British Government—as far as I am aware, they are supported by the Opposition in this—have a policy of devoting 0.7% of our GDP to aid, and to achieve this within the next two years. Furthermore, as far as I understand it, they are committed to making this a statutory obligation, unlike any other form of public expenditure. Do you think that this makes sense?

Rory Stewart: It seems to me that this is driven by an ethical argument rather than a practical argument. The decision to devote 0.7% of GDP was derived not from a sense of capacity but from a sense that we felt that wealthy countries should aim to have an obligation of giving a certain proportion of their GDP to poorer countries. It is an argument based on equality and compassion. I think that the problem with it is a problem of capacity. At the risk of repeating myself, I would say that the Achilles' heel to this whole idea is that "ought" implies "can". You do not have a moral obligation to do what you cannot do.

Lord Lawson of Blaby I understand that, but might it not be the case that another fault of this approach is that it focuses on the input of how much money is being spent rather than on the output in terms of achieving specific objectives and effectiveness generally, which, ostensibly, DfID is very keen on, and on which it is trying to improve its measurement? But if this approach is driven overridingly by the amount of money that has to be spent under this commitment, does that not detract from the focus that it says there ought to be on outcomes and effectiveness?

Rory Stewart: My instinct is that those are very legitimate concerns. You can understand why, in the context in which the 0.7% was arrived at, the British Government felt that there was a moral obligation incumbent on countries to devote this money.

Lord Lawson of Blaby: But no other Government has done this. No other Government has this commitment. Indeed, our partners in the European Union, France and Germany, are in fact reining back on that because of the difficult economic conditions, or maybe partly because of that and partly because of disillusionment with the effectiveness of aid. But for whatever reason, they are reining back on the achievement of this international target at a time when we are ploughing ahead. I understand what you are saying, but it is a curiosity, is it not?

Rory Stewart: It is certainly very curious. My intuition is that if the British Government wish to stick with this target, they need massively to increase the number of staff committed to this matter, change some of the internal culture of the organisation, abandon certain projects and prioritise other kinds of projects. In essence, there needs to be a very considerable bureaucratic and institutional reform to ensure that these added sums of money can be spent correctly. At the moment, I would be worried that we do not have those structures in place.

Lord Forsyth of Drumlean: You did not deal with the second point of Lord Lawson's question.

Rory Stewart: Probably deliberately.

Lord Forsyth of Drumlean: That is, leaving aside the question of whether it is right to have a target of 0.7%, and all the arguments for and against that, is it sensible for it to be enshrined in statute?

Rory Stewart: I was deliberately avoiding that question.

The Chairman: You certainly know where Lord Lawson is coming from. I quite understand. Thank you very much for coming. You have given us an awful lot of time. This has been a thought-provoking and stimulating session for us and has been based very much on your practical experience. We are most grateful to you. Thank you very much.

Mr Finn Tarp—Written evidence

On the Effectiveness of Development Aid: A Brief Personal Account of 40 Years of Research

Director, UNU-WIDER and Professor of Development Economics, University of Copenhagen

Introduction

1. Not a month goes by without some sort of bad news about foreign aid. Examples of incompetence, abuse of funds by corrupt leaders, and distorted incentives abound. These stories fuel a deep skepticism of foreign aid. In this view, perverse effects dominate – aid ends up weakening, rather than encouraging, growth and development. If one accepts this view, then it is logical to turn off the poisoned tap of foreign aid. But are such views well founded when one takes a look at the insights derived from the many analytical studies economists have carried out over the past 40 years?

2. No well informed individual believes that aid has been beneficial in all places at all times. Even if aid helps, too much aid relative to a country's institutions and governance is likely to have a corrosive impact on economic policy, and there is clearly ample space for aid to do better.[440] Anecdotes of aid failures simply reaffirm these well accepted points. A key question is whether, on average and over time, aid has stimulated economic growth and development in a manner consistent with reasonable expectations. I address this issue in what follows and argue that the analytical evidence of aid's effectiveness is by now quite convincing – in spite of the inevitable methodological challenges involved.

Three sources of evidence

3. There are in general three sources of evidence economists use when analyzing aid effectiveness and they all point consistently to a positive impact of aid on economic growth and development on average and over time.

4. First, independent evaluations of aid projects have been and remain largely positive. For example, in 2008, the World Bank's Independent Evaluation Group deemed 81% of evaluated projects as satisfactory or better. In addition, the Bank's performance has been on an upward trend over the last 15 years with the share of projects rated as satisfactory or better increasing by about 15 percentage points since the early 1990s. Outside of the World Bank, development economists have been at the forefront of the application of randomized experiments to economic policy issues in developing countries. These have rigorously demonstrated the potential for well-designed interventions to make substantial and cost-effective improvements to development indicators.

5. Second, important improvements in sector-level outcomes have taken place in all regions. These largely refer to human development indicators and there is an increasing body of literature that links these improved outcomes to aid interventions either directly

[440] This was argued, for example, by a group of 29 authors in Finn Tarp (ed) (2000). *Foreign Aid and Development: Lessons Learnt and Directions for the Future*. London and New York: Routledge. See http://www.routledge.com/books/details/9780415233637/

or indirectly, and these gains extend to Sub-Saharan Africa (SSA), where development performance is generally regarded as the least impressive overall (until recently). In 1960, the gross primary school enrollment rate in SSA was only about 35%. By 2005, the rate had improved to about 95%. The HIV/AIDS pandemic has led to limited gains in life expectancy in SSA. Nevertheless, the infant mortality rate improved from about 150 per 1,000 live births to about 100 between 1960 and 2005, and also, indicators of child malnutrition have improved in SSA though much less rapidly than in other developing regions.

6. It is hard to argue that development aid has had no role in these achievements – when comparing with how Africa would have fared without aid. So, it is not here analysts diverge – it is in debate about the macroeconomic and growth impacts of aid.

Aid and growth

7. Macroeconomic studies of the relationship between aid and growth date back to the early 1970s and work since then can broadly be categorized into four groups – each representative for their decade.

8. First, early work in the 1970s and 1980s was really very simple, based on basic (correlation type) cross-country growth regressions, and it used to be argued in the policy debates of the 1980s that (i) this literature led nowhere, and (ii) that economists – as always – disagree among themselves. Yet, this is simply incorrect – it is not a fair representation of the available evidence. Take a look at the following paper:

   Hansen, H. and F. Tarp. 'Aid Effectiveness Disputed'. *Journal of International Development*, Vol. 12(3), 2000, 375-98. For access to this paper see http://onlinelibrary.wiley.com/doi/10.1002/(SICI)1099-1328(200004)12:3%3C375::AID-JID657%3E3.0.CO;2-M/abstract

   Henrik Hansen and I put together all of the 131 studies (or regressions) that belong to the first and second generation literature. What did we find? One regression showed that aid impacts savings negatively and one study shows that aid impacts negatively on growth. All the remaining 129 studies showed either positive impact or could not give a statistically significant (meaningful) answer.

9. Please note the above study has to date not been challenged by anyone – but the economics profession has nevertheless continued to quibble because the methodological goal posts moved in the early 1990s. New methods and panel data came in focus, so the "old" literature was left behind – a 3rd generation was taking over, but were new insights emerging from the "grand children"?

10. *The Economist* spoke early on in the 1990s about "aid down the rat hole", citing some of the new 3rd generation studies. What *The Economist* has not done is to report comprehensively about what happened subsequently. First, the World Bank put out a set of studies that suggested that aid does indeed seem to work under a set of specific circumstances. While there was no agreement in the profession about the nature of these conditions, the conclusion that aid seems to work was, second, brought forcefully home in the following paper:

Hansen, H. and F. Tarp (2001). 'Aid and Growth Regressions'. *Journal of Development Economics*, Vol. 64(2), 547-570. See http://ideas.repec.org/a/eee/deveco/v64y2001i2p547-570.html

11. This paper was widely seen as providing the most robust answer at the time, but as the international policy debate about foreign aid started to focus on the need to "double aid", the methodological goal posts moved again. The fourth generation studies came along, fuelled by reservations about the analytical methodologies used in the previous generations, and arguing that there were better ways to do this kind of work. The IMF research director,[441] for example, noted that the economics profession needed to rely on long run cross section averages. Moreover, in his work, he could – unfortunately – not find the impact of aid on growth. So, once again, back to square one? Well, not quite. In a careful analysis of the Rajan and Subramanian work (a rebuttal if you wish) a variety of shortcomings were identified – see:

    Arndt, C. S. Jones and F. Tarp (2010). 'Aid, Growth, and Development: Have We Come Full Circle?' *Journal of Globalization and Development*. Vol. 1(2), Article 5. Available for downloading from http://www.bepress.com/jgd/vol1/iss2/art5/

    In this piece it is noted that with respect to economic growth, rather than the performance of aid being too low, expectations of the growth impact of foreign aid have been systematically too high. Based on modern economic growth theory and treating aid as an investment, a 10% share of aid in GDP should lead, on average and over time, to approximately a 1.5 percentage point increment in per capita growth. As the average share of aid in GDP across recipients has been around 3.5% (1970-2000), the expected average increment to per capita economic growth is only about half a percentage point.

12. Empirically testing these theoretical predictions is challenging given the low quality of data and the complexity of growth processes. Nevertheless, careful (repeated) analysis – over 40 years – has frequently found a positive and significant impact of aid on growth on average and over time – and this is so for all of our four generations. The latest estimates (by Arndt, Jones and I) of the causal impact of aid on growth fall squarely within the range predicted by growth theory – and they are statistically significant at the 1% level. Moreover, when we "unpack" the aggregate result we find a relatively simple story is lurking in the background: aid stimulates growth and reduces poverty via physical capital investment and improvements in health. Put differently, there is no systematic evidence that perverse economic effects from aid overshadow its benefits, neither in the last (most modern study) nor across time, when looking at all this from a bird's eye perspective.

Other pieces of the puzzle

13. A key problem in the analysis of aid and growth is that the data series have so far been quite short and insufficient. This has made it necessary to rely on cross country work to a much greater extent than anyone really feels comfortable with. Yet, this is changing – as time has gone by – and in work that will be put out within the next few months I will show together with Prof. Katarina Juselius, one of the world's leading econometricians, that across African countries the time-series evidence is quite convincing – and broadly

[441] See Rajan, R. G. and A. Subramanian (2008). 'Aid and Growth: What Does the Cross-Country Evidence Really Show?' *The Review of Economics and Statistics* 90(4), 643-665. See http://ideas.repec.org/a/tpr/restat/v90y2008i4p643-665.html

in line with the above insights. The same goes for the following detailed study of aid's indisputable success in the case of Mozambique, a country I have followed closely for more than 30 years:

Arndt, C., S. Jones and F. Tarp (2007). 'Aid and Development: The Mozambican Case'. Chapter 14 (pp. 235-288) in S. Lahiri (ed.) Sajal Lahiri (ed) *Frontiers of Economics and Globalization: Theory and Practice of Foreign Aid*, Elsevier. For the working paper version of this book chapter see http://www.econ.ku.dk/ftarp/workingpapers/Docs/Aid%20and%20Development_The%20Mozambican%20Case.pdf

14. There may finally be reason to note that one will find claims "out there" in the literature that the so-called meta-approach to studying aid and growth suggests that aid has no impact.[442] May I encourage anyone to take a look at the following study before they decide what to make of this claim of lack of impact?

Mekasha, T. and F. Tarp (2011). 'Aid and Growth: What Does Meta-analysis Reveal?' *WIDER working paper* 22. Available for downloading from http://www.wider.unu.edu/publications/working-papers/2011/en_GB/wp2011-022/
The reader will note that Tseday Mekasha and I show that meta-analytical insights are fully consistent with the work of Arndt, Jones and Tarp.

Conclusion

15. In sum, the balance of the existing up-to-date analytical evidence points to positive impacts of aid on average and through time. Aid has been and remains an important tool for enhancing the development prospects of poor nations. It is, in concluding, also pertinent to recognize that there are lots of countries (take Korea and soon India as but two examples) that used to get lots of aid and which have now "graduated" – and few question that aid has been important in for example Vietnam's sustained economic success. Faced with 21st century challenges such as climate change and the clear menace posed by failed states, abolishing foreign aid, or drastically cutting it back, would be a serious mistake. Allocating aid wisely and making it work better would increase impact and the returns of this investment.

16. Finally, a more realistic assessment of the potency of aid gives renewed emphasis to other mechanisms, such as international trade and technology development, through which wealthier countries can help facilitate economic growth and development in poorer countries. In an inter-connected and inter-dependent world, the challenge is to wisely employ ALL the available tools, including development aid, to advance living standards in poor countries and to meet 21st century challenges.

16 June 2011

[442] In the meta-literature each study is treated as an observation in line with research of the controlled experiment type, known from medical research.

Jonathan Temple and Patrick Carter—Written evidence

Submission to be found under Patrick Carter and Jonathan Temple

Transparency International UK (TI-UK)—Written evidence

Introduction

1. A description of Transparency International UK (TI-UK) is provided in the Annex.

2. TI-UK welcomes this inquiry by the House of Lords. As an anti-corruption organisation, TI-UK is primarily concerned about the need for greater transparency and accountability in the provision and use of development aid. TI defines corruption as the abuse of entrusted power for private gain. Corruption has a hugely damaging impact on economic growth and sustainable development because it diverts scarce resources from development programmes, undermines the rule of law and weakens public and private institutions that are essential for growth and stability. This is an especially acute problem where corruption leads to the depletion of capital resources and capital flight.

3. TI-UK welcomes the UK Government's commitment to increasing development aid to poorer countries in order to help them to attain broad-based economic growth as well as specific targets such as the UN Millennium Development Goals. However, weak governance and corruption can undermine the effectiveness of the UK's development aid. Measures to reduce overseas corruption should therefore be integrated into the Government's overseas aid strategy.

4. At the same time, the UK should be ensuring it reduces its 'corruption footprint' abroad. When UK nationals and companies pay bribes in the developing world to win business unfairly, and when UK institutions provide a safe haven for the illicit wealth of corrupt foreign leaders, the UK becomes complicit in perpetuating corruption in these countries, many of whom are recipients of UK development aid. The effective enforcement of the new Bribery Act and a strengthening of the UK's anti-money laundering regime should therefore be given a high priority.

5. This submission by TI-UK responds chiefly to question 12 of the House of Lords Inquiry: "In what ways, if any, can the British government improve the effectiveness of its development aid?"

Tackling corruption is essential in order to improve the effectiveness of UK aid

6. Over the 5 years from 2005 to 2009, 84% of the UK's bilateral ODA was allocated to countries scoring 3 or less on TI's Corruption Perceptions Index (10 is highest attainable score on the Index). It is therefore understandable that the Government's decision to increase rapidly both the aid budget to an amount equivalent to 0.7% of Gross National Income and the proportion going to fragile and conflict-affected states has raised fears that, because of weak governance and corruption, the increased aid will not have the desired impact on poverty reduction and may actually create greater opportunities for graft.

7. Over the years, the UK and other bilateral and multilateral donors have, as part of their overseas development intervention strategies, invested considerable resources in encouraging recipient governments to introduce governance and anti-corruption reforms. These included the establishment of independent anti-corruption agencies that were

supposed to spearhead investigative and law enforcement efforts. However, the record has been patchy, particularly when there has been insufficient support from domestic constituencies for reforms and deeply entrenched corrupt networks have been able to frustrate reforms.

8. In several countries, anti-corruption agencies have been starved of resources and subverted by political pressure. It is therefore doubtful whether anti-corruption reforms can be successful when they are promoted by donors without sufficient support from domestic constituencies. There is no easy solution to this problem. However, if the UK and other donors were to withdraw aid from countries where corruption is endemic and deeply entrenched, they would have no leverage to encourage reforms and this would hurt the poorest and most vulnerable groups in these countries - they are disproportionately affected by corruption and their situation is likely to worsen if aid were to be withdrawn.

Wider context

9. In spite of the widespread phenomenon of corruption, TI-UK agrees with the earlier observation made to this Committee by Roger Ridell that aid has had a broadly beneficial impact at the level of the maco-economy, particularly in capital-scarce poorer countries. However, the issue in question is whether these countries' growth rates could be further improved by a serious attack on corruption, and, in particular, whether a broader based form of growth, embracing the lowest income groups, is achievable. The question has become more complex in the recent past as the range of financial flows into many developing countries has increased (e.g. high levels of remittances, a sharp increase in FDI, major investments in resource extraction by China) in ways which increase the difficulty of isolating the impact of aid.

10. The increase in the value and complexity of aggregate flows means that in practice the leverage of donors in relation to 'soft' governance reform issues is much reduced. For example in April 2011, Uganda purchased Su30 fighter planes from Russia for $750 million, or nearly 75% of expected aid flows this year. Yet Uganda has been a prime target of governance reforms by DFID and other donors.

11. Often, the real obstacle to the leverage which donors have sought in order to support anti-corruption efforts are the corrupt networks which control the political finance which keeps governments in power. This may take the form of political funding (as in the Anglo Leasing scandal in Kenya) or of measures to secure votes for constitutional change (as in the bids for third and fourth presidential terms by Presidents Obasanjo and Museveni, respectively). There is no evidence to suggest that the strength of the process of financial accumulation through various forms of corruption for political purposes has yet abated.

12. There are additional structural problems in a majority of aid recipient countries which underpin the sinews of corruption and are particularly difficult problems to address through donor strategies. These are, in particular, the size of the informal economy, the extent of organised crime, and government complicity in very light tax regimes for multinational and other companies. The informal economy in nearly all low-income countries accounts for at least 30% of GDP – flows into and out of this part of the economy are not recorded, elude the tax net, and are regularly used to bribe local and national officials. Organised crime, primarily but not only connected to the drugs trade, is a force which exerts corrupt influence on governments, and thus reinforces corruption at the

national level. UNODC's World Drugs Report for 2009 highlighted this issue in relation to West Africa. Separately, light or zero-tax regimes are now widely recognised as an issue in many natural resource exporting countries. The Dodd Frank legislation in the US, if it is emulated with comparable legislation in the EU, will help to exert pressure on governments in this area, because of the requirement for mandatory reporting of all extractive company payments to governments on a country-by-country and project-by- project basis.

13. These structural problems reinforce corruption but donor policies presently do not pay sufficient attention to them.

Dilemmas

14. There are some key dilemmas which need to be recognised in shaping policies which seek to address the complexities of corruption. First, in relation to leveraging 'soft reforms', the role of an outside agency will always be constrained since it cannot by definition have democratic legitimacy. As noted earlier, this has been reflected in the patchy record of donor support for good governance through interventions ranging from support to anti-corruption bodies and parliamentary accounts committees. Although in some countries there is discernible progress at the level of national integrity systems, and at the level of support to civil society, it is very modest in relation to the total sums expended on these programmes.

15. Second, donors face a conflict between their 'development' aims and the commercial, export-oriented aims of their leading companies. TI's 'Bribe Payers' Index' has consistently shown that construction and defence are among the most corrupt sectors worldwide. Many donor countries, including the UK, have in the past provided active support to their companies trading in these sectors and turned a blind eye to corruption, a fact which is recognised by many aid recipient countries. Although several international initiatives, and national anti-bribery laws, have changed the regulatory environment, there continues to be a tension between export promotion and promoting good governance. It also remains to be seen whether India, China and Russia - who are major players in global export markets and, increasingly, are also sources of development aid - will enforce effectively the new foreign bribery laws they passed/introduced in 2011.

16. Third, the design of many large scale aid programmes has become more complex over time as donors have sought to promote, for example, competitiveness or improve the construction of wells in thousands of villages. This 'disaggregration' of the level of the end client creates many opportunities for corruption at the local level, as confirmed by many surveys by national chapters of TI and other organizations reviewing the delivery of services such as water and education.

Broad Recommendations

17. Given these arguments TI-UK considers that the following broad considerations should be observed in relation to UK aid policy:

1) The specific target of increasing aid to 0.7 per cent of Gross National Income should not in itself be a goal of the aid programme: such a target can easily lead to an evasion of the issue of the impact of corruption on development.

2) Aid can have some influence on 'governance' issues but can never be decisive. Moreover, in this area in particular its impact can only be measured over several years; the complexity of financial flows to low-income developing countries has lent further weight to this limitation.
3) All donors, including DFID and the international financial institutions (IFIs) which it supports, should be prepared to have their programmes subject to parliamentary debate in recipient countries, as part of the normal process of democratic accountability.
4) A key part of donor strategy should be to see a reduction in the size of the informal economy, as a means to both reducing a critical source of corruption and to increasing the tax take; mandatory reporting by companies of payments to governments on a country-by-country and project-by-project basis could be expanded beyond extractive industries to cover all sectors. This would help to reduce the connivance between governments and companies in tax evasion.
5) The UK, in line with other donors, should continue to build consistency between its aid and export promotion policies, taking into account the need to enforce effectively the UK Bribery Act.

Specific Recommendations

18. TI-UK believes that the UK and the recipients of its development aid will be more effective in responding to the challenges of weak governance and corruption through an approach based on mutual accountability between the recipient government and all donors. In high corruption-risk countries, there should be agreement on a clearly defined programme of specific reform measures that can be monitored both by Parliament and by a donor consortium. Since public financial resources are inherently fungible, the steps needed to ensure that aid is not corruptly diverted are the same as those needed to ensure effective overall public financial accountability. TI-UK makes the following specific recommendations, some of which build on recommendations made by the Independent Commission for Aid Impact (ICAI) to strengthen DFID's approach to anti-corruption (see ICAI's Report 2, November 2011):

I. In any country assessed as having a high risk of corruption, DFID working with other donors, including the IFIs in which it is a major shareholder, should develop an explicit anti-corruption strategy.
II. DFID should be proactive in assessing and mitigating corruption risks. It should review the structure and nature of its counter-fraud and anti-corruption resources and develop a more co-ordinated approach to risk assessment, risk management, anti-corruption programming and fraud response taking into account the UK institutions which can collaborate with aid recipient governments in tracking funds and freezing assets where appropriate.
III. The Government's current Anti-Corruption Champion, the Secretary of State for Justice, and the Secretary of State for Development should work more closely to ensure that a coherent, co-ordinated approach to tackling overseas corruption is integrated fully into the UK's overseas aid strategy.
IV. Building on its Fiduciary Risk Assessments, DFID, with its partners, should undertake country financial accountability and procurement assessments and develop credible, time-bound action plans for reform of budgeting, accounting, audit and procurement systems. This would build on the existing Public Expenditure and Financial Accountability programme that DFID, the World Bank and other donors support.

V. All civil society organisations (CSOs) through whom development assistance is disbursed, should be required to adhere to a common verifiable standard for monitoring and auditing their use of aid monies. CSOs should also have robust internal systems for countering bribery and corruption. TI-UK and other partners in BOND have developed NGO Principles and Guidance for Countering Bribery[443], which can assist CSOs in developing such systems.

VI. All aid funds should be recorded in recipient governments' budgets and subject to legislative and other oversight mechanisms. The transparency of public income and expenditure management, all aid transactions and the related monitoring systems should be increased.

VII. In accordance with the International Aid Transparency standard, UK and other donor aid budgets should be presented in a transparent way so that the public in both the donors' and recipients' countries know the precise nature of commitments and disbursements.

19. In making these recommendations TI-UK is conscious of the fact that there are many challenges to be overcome in rolling back corruption, so that aid will be more effective. In countries where corruption is endemic the injection of very large sums of capital will never be corruption-free. This is equally true of the funds designed to mitigate or adapt to climate change, such as the Reducing Emissions from Deforestation and Forest Degradation programme and the proposed Green Climate Fund. Corruption undermines broad-based development and all donors, including DFID, need to adopt a more robust approach in addressing the problem, which recognises the underlying forces which drive corruption as well as its more public manifestations.

December 2011

Annex

Transparency International UK (www.transparency.org.uk), the UK national chapter of TI, fights corruption by promoting change in values and attitudes at home and abroad, through programmes that draw on the UK's unique position as a world political and business centre with close links to developing countries.

TI-UK:

- Raises awareness about corruption;
- Advocates legal and regulatory reform at national and international levels;
- Designs practical tools for institutions, individuals and companies wishing to combat corruption; and
- Acts as a leading centre of anti-corruption expertise in the UK.

TI-UK's vision is for a world in which corruption is greatly reduced and the UK has zero tolerance for corruption both at home and abroad.

443 http://www.transparency.org.uk/publications

Transparency International UK—Oral evidence (QQ 480-509)

Evidence Session No. 14. *Heard in Public.* *Questions 480 - 509*

TUESDAY 13 DECEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Lord Hollick
Lord Lawson of Blaby
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton

Examination of Witnesses

Chandrashekhar Krishnan, Executive Director, and **Laurence Cockcroft**, Member of the Board of Trustees, Transparency International UK

Q480 The Chairman: Good afternoon, gentlemen, and apologies for the slight delay, but we had some internal business to conduct. This is the 14th public hearing of our inquiry into the impact and effectiveness of development aid. As I have to say at every meeting, copies are available of Members' entries in the Register of Interests. We are very grateful to you for coming and we are very much looking forward to this session. I thank you also for your written evidence to us, which, if I may say so, I thought was concise, very helpful and persuasive. I think that it demonstrates some of the difficulties in tackling corruption, which is in particular what we want to explore with you this afternoon, so thank you very much for that. Before we proceed to specific questions, could you briefly outline the methodology underlying the Transparency International Corruption Perceptions Index? What are the main inputs and judgments?

Chandrashekhar Krishnan: Thank you, my Lord, and thank you to the Committee for giving us the opportunity to give oral evidence. The Corruption Perceptions Index is published by TI annually. It is based on perceptions of the extent to which corruption is a problem in the public sectors of the countries that are surveyed every year. The last index was published two weeks ago and covered 183 countries. Our researchers in TI take 17 surveys, which have been conducted by 13 other institutions, including, for example, the World Bank, the Economist Intelligence Unit and the African Development Bank. They take the data from those surveys, collate them and assign scores to countries, ranging from zero to 10. Ten is the highest score that you can attain and it denotes least corrupt, whereas zero is the worst score, denoting most corrupt. Those scores are taken to rank countries on the index, which is what you see every year. Countries that score high—this year, New Zealand was at the top—are perceived to be the least corrupt, whereas Somalia, which was ranked right at the bottom, is perceived to be the most corrupt. It is a perception-based tool. We think that it is valuable in spotlighting the problem of corruption and in encouraging more attention to be focused on the problem.

The Chairman: So it is not based on your judgments; it is based on a lot of evidence from other organisations.

Chandrashekhar Krishnan: That is right. If I may, I should point out that we also have other tools. We also publish a Global Corruption Barometer, which is a Gallup poll of public opinion worldwide. It measures both perceptions of corruption and the experience that people have had in terms of whether they have paid bribes, whether they think that corruption is increasing in their countries, which institutions they think are most corrupt and so forth. We can tell you more about that if you wish. We also have something called the Bribe Payers Index, which measures perceptions of the extent to which companies incorporated in the 28 major exporting nations have a propensity to pay bribes when they are operating overseas. I should also mention that many national chapters of TI conduct their own surveys and assessments of corruption from time to time. We in TI take the results of all that information and we make our own judgments in terms of what is happening to corruption around the world.

Q481 The Chairman: How many national chapters do you have?

Chandrashekhar Krishnan: We currently have 87 national chapters. We also have about 10 national chapters in formation and we have contact points in, I think, another five countries around the world.

Lord Lawson of Blaby: You are very good at rating from nought to 10. Among the various chapters that you have, where would you rate Transparency International UK?

Chandrashekhar Krishnan: I beg your pardon. Where would we rate the UK?

Lord Lawson of Blaby: No. Of all the various national Transparency International chapters, are you the biggest and the best, the second or the third? Where do you rank?

Chandrashekhar Krishnan: I would like to think that we are among the best. In terms of our budget, we are by no means among the largest. I think that Bangladesh is the largest chapter, in terms of both its national budget and its staff, which exceeds 300. We have a staff of about 25 right now. Our annual turnover is about £1 million. We are one of the oldest national chapters. We were founded in 1994. In fact, Laurence Cockcroft was a founding member both of TI and of TI UK.

The Chairman: Any other questions on the facts?

Q482 Lord Lipsey: I wonder, Lord Chairman, through you whether we might ask for a short note setting out the methodology of TI, because there are all sorts of questions such as weightings that you put to different surveys, who is included in various surveys and so on. I think that it would be right to make that transparent for the Committee by doing a short supplementary note, if you would.

Chandrashekhar Krishnan: We will very happily do that. A methodology note is on the TI website and we will be very happy to provide it to the Committee.

Lord Lipsey: We have not had it distributed, so it would be helpful if you could provide it for the record.

The Chairman: Any other questions of fact? If not, we will move on to more substantive questions.

Q483 Lord Lawson of Blaby: Let me go straight into the issue of corruption, which is obviously what you are quite properly concerned about. I would like you to tell us your view of the effects of corruption, as you see them, on economic development and economic growth in the recipient countries. Obviously, there are all sorts of other things about corruption—the fact that it is immoral, it lines pockets that should not be lined, and so on—but what do you think its effect is on economic development?

Laurence Cockcroft: I will answer that, if I may. I would rather like to look at that in the context of the impact of corruption on different entities: first, at the level of individuals; secondly, at the level of the macro economy; and, thirdly, at the level of the environment. In each case, I think that one can see that corruption is very devastating.

As I am sure everyone in the room knows, the impact on individuals in countries where corruption is endemic can be extraordinarily serious. I am talking about the incidence of corruption at the grassroots, by which I mean, for example, access to a hospital, sometimes access to broader health services, quite often dealing with the police and certainly access to water distribution facilities. All these issues of individual access to a marginally improved living standard are in very many countries threatened by one form of corruption or another. A wealth of evidence has been collected, not only by TI but by many organisations, over the last 15 years, certainly, which quantifies this in a very substantive way, so that it is possible to show that in west Africa, for example, in order to progress from primary school to secondary school, in 30% of cases it may be necessary to pay a bribe to somebody. Because of the cost of informal water distribution systems in big cities such as Nairobi, Lima and so on, the cost of water distributed by individual private water sellers may be five times that in the public system, which benefits the wealthy sections of the community. Of course, there are some really frightening stories in relation to HIV, where the Global Fund, which is in theory responsible for funding the distribution of retroviral drugs in relation to HIV, has found that some of those are redistributed on a corrupt basis and are benefiting sections of the community other than the target groups.

I think that it is not really contestable that the impact of corruption on individuals at the bottom of the social and economic ladder is extremely serious. Sometimes that is defended as a question of need, because people are on such low salaries that they are, as it were, forced to start charging a bribe for their services. TI as a whole and certainly myself as an individual are rather wary of that argument, because sometimes these things are organised as a scam. You may find that the chief of police who is organising a roadblock is expecting the organisers of the roadblock to take home a certain sum every week on pain of the individual police officer losing his job. One has to look at this in quite a hard-headed way. I would say that corruption at the level of the individual who is at the bottom of the ladder is not just a matter of individual action by a poorly paid civil servant; it is sometimes—one might say in certain contexts quite regularly—the subject of some form of organised arrangement.

Perhaps I can just move up to the macro level of the economy for a moment. I think that we can easily see that corruption on large-scale projects—by which I mean infrastructure, public buildings and roads—frequently leads to inflated costs because, in a collusion between contractors and those who are organising the tender, there is an agreement that a certain percentage of the sum will be diverted to the public servant who is letting the tender or, more often, to a complex network of people who are involved in the arrangements surrounding that infrastructural investment. Then of course one can often show that in countries where there is a choice between using a local contractor and an international contractor, where individuals are interested in getting hold of foreign exchange, there is a huge drive to establish a foreign-exchange-intensive project in order to be able to repatriate some of those funds into offshore centres, in ways that lead to quite dramatic levels of capital flight, which of course are quantified in IMF-type figures [if they do not escape national income statistics altogether].

Another issue at the macro level is the tax system. It is easy to forget the fact that tax collection systems in nearly all countries where corruption is endemic are extremely inefficient, so that the tax take is well below the tax take in OECD countries as a percentage of GDP. This is partly because people are finding it extraordinarily easy to do deals with local tax inspectors. I am not now just thinking of multinational companies; I am thinking at the level of small-scale businesses who may have a turnover, for the sake of argument, of $10,000 to $20,000, whose operations are not recorded, who do not really have accounts and who will buy off a tax inspector when he comes to make an assessment. Of course, this feeds into the broader argument about aid, because if tax takes were organised more efficiently, the requirement for aid resources would be rather less.

I would like finally to refer at the macro level to something more dramatic than these points, which is sometimes referred to as grand looting rather than grand corruption, where a project is funded that never really existed in the first place. These are the kind of ghost projects that any among you who has followed the work of John Githongo in relation to the Kenya Government will know about. John Githongo was associated with exposing something called Anglo Leasing, the nub of which was that the projects for which the Government had set aside huge sums involving in total several hundred million dollars were either non-existent or much smaller than the ticket price.

The point about all these things at the macro level is, in terms of economic policy, that they feed into the distortion of markets. Let us take the Washington consensus and the view on which development policy has operated for the last 20 years. Generally, the assumption has been that markets work and that the right strategy in terms of development is to make markets function. Too much of that discussion has failed to recognise the fact that markets do not function in many of the countries that we are concerned with—or, perhaps more accurately, are hugely distorted by forms of corruption, including those that I have mentioned. The whole concept that you can create a functioning market that will deliver growth, regardless of whether there is a high level of corruption, which certainly was the parameter in the 1980s and 1990s—it has been rather less so in the last 10 years—has been based, as one can easily show, on a very fallacious assumption and a walking away from the distortions created by corruption at a macro level.

The third point that I would like to make in terms of impact is at the level of the environment. Obviously, in a world in which we are all now very conscious of environmental issues, the question of the impact of corruption on, for example—to take the easiest case—deforestation is very dramatic. In countries such as Indonesia, DRC and Brazil, which have the world's largest forest resources, we have seen during the last 30 years—certainly since the 1960s—deforestation on a huge scale, which obviously has contributed to the problem of deforestation internationally and so to the issue of diminishing carbon sequestration and so on. I think that one has to recognise that corruption can be a driver of environmental degradation and feeds into the issues that are so current at the moment.

I would like to make one final point in relation to this. It is often said that this issue of corruption in development is very misleading, because we can see that among the Asian tigers there was a lot of corruption but there has also been a high level of economic growth, so why should we worry about this? I think that one has to be objective enough to recognise, first, that corruption is not necessarily always negative from the point of view of economic growth. If one can show that the net effect of corruption is resource enhancing, by which I mean that huge capital sums gained from corruption are reinvested to mobilise land and labour in whatever domestic economy we are talking about, that is hugely different from resource depletion. The extreme example of resource depletion would be Nigeria, which has had exports of $30 billion a year since the 1990s and at the grassroots very little to show for it. That is an example of resource depletion associated with capital flight. South Korea will be an example of corruption that is to some extent resource enhancing and in which capital flight has been much less dramatic. A country such as South Korea none the less has huge problems which arise from corruption, but they are not the problems of negative growth—that would obviously be a very fallacious argument. I would just like to note that point, because I think that it is a very important distinction, which people often do not like to recognise.

Q484 Lord Lawson of Blaby: Thank you very much. That was a very full and excellent answer, if I may say so. Perhaps I may pick up on three of the many points you made. The first is an observation. You said that the market economy was the answer. Of course, the market economy only makes sense if there is the rule of law. Without the effective rule of law, probably nothing works—not just the market economy. Clearly the rule of law is important, which brings us back to corruption. Capital flight is a major factor in the equation. A long time ago when I was Chancellor, there was a real problem in Latin America. It was quite clear that as fast as aid and other loans were going in to these countries, the wealthy were getting their capital out. In fact, probably more was going out than coming in. Certainly that was what happened to most of the money that went in. At the time, for understandable reasons, the figures for capital flight did not have any degree of accuracy. Has more work been done on capital flight since my time? I am totally out of date. If so, it would be helpful if you could let us have a note about capital flight on a country-by-country basis—if even approximate figures exist.

Laurence Cockcroft: There is an excellent organisation called Global Financial Integrity, which does analytical work on this. It looks at capital flight from different sources, including transfer pricing, organised crime and the issue of, as it were, individual-engineered capital flight. In my opinion it has very good statistics, based obviously on IMF figures. The team is led by an ex-IMF senior economist and uses IMF statistics to derive the figures. Of course, there is always a lot of debate—I hesitate to mention this to you—about the value of residual figures and whether you can assume that when an export from Malaysia of $100 million shows up as an import to the US of $150 million it should be accounted for by capital flight or inefficient statistics. The issue remains controversial.

Lord Lawson of Blaby: That is a good point. Most trade statistics—including our own, I have to say—do not bear too much examination. Nevertheless, the figures would be interesting to us as being indicative, even if they cannot be taken as gospel.

Laurence Cockcroft: I would be very happy to supply them.

Q485 Lord Lawson of Blaby: Thank you. I will ask my final question. You mentioned the Anglo Leasing scandal, which has become well known, perhaps thanks to Mr Githongo in particular. Can you illustrate the general points that you made by any other specific examples?

Laurence Cockcroft: The short answer is yes—in a variety of contexts, really. That happened to be a particularly dramatic one because it was put together by somebody who was very good at talking about it and very courageous in exposing it. In the country next door, Tanzania, there have been three mega-scandals in the past 10 years. I am sure that everybody here is familiar with the BAE radar surveillance system scandal, but a couple of others were also very dramatic. One is known as the EPA—external payment account — scandal, in which a series of credits due to Japanese suppliers were diverted from overseas suppliers to the domestic market simply by redesignating the letters of credit in question and transferring the cash to a series of shell companies which then promptly put them in a bank called Bank M. The funds, which totalled about $130 million, were used certainly in part to fund subsequent political campaigns. That is not exactly the same example, but it is fairly similar.

There is also the case of Zambia under Chiluba. The case that ended up in a London court, in which £30 million was transferred to an account of the Zambian intelligence services in London, involved a completely fictitious transfer for services that were never supplied. This is not the same point, but in the South African defence deal of 1998, in which a consortium of European companies including BAE Systems was involved, the overpricing ran to as much as $500 million, of which some was recycled offshore. There were a couple of arrests, but by and large it is fair to say that the case was suppressed in the South African courts.

Q486 Lord Forsyth of Drumlean: In your excellent written evidence you said that 84% of Britain's bilateral aid from 2005 to 2009 went to countries at the bad end of your Corruption Perceptions Index. Can you tell us what the trend has been in recent years? Is it getting better or worse?

Laurence Cockcroft: The trend in the sense of aid flows?

Lord Forsyth of Drumlean: Corruption. Is the number less than 84% or more?

Laurence Cockcroft: My colleague will answer that.

Chandrashekhar Krishnan: Broadly speaking, the percentage of UK bilateral aid that goes to countries scoring less than three on the index has come down. It was about 90% in 2005 and has come down to about 73%. If the question is about what is happening to corruption in the recipients of UK aid, there is a problem in answering that question. The problem is one of data. Unfortunately, the TI Corruption Perceptions Index cannot be used to make intertemporal comparisons because the number of countries in the survey varies from year to year. The surveys that are used as the source of the data for calculating scores may also vary over time, so you are not always comparing like with like.

I will take a finding from the other tool I mentioned, namely the Global Corruption Barometer. As I mentioned, it is a global opinion survey. The last one was done in 2010. We polled 90,000 people all over the world in 86 countries, many of which are recipients of UK aid. In five countries that were among the 10 largest recipients of UK aid between 2005 and 2009, on average 75% of respondents felt that corruption had become worse. The countries were Bangladesh, India, Iraq, Nigeria and Pakistan. In 10 countries in sub-Saharan Africa, all of which received UK aid in that period, on average 60% of people felt that corruption had become worse in the preceding three years. The only exception was Sierra Leone, where only 30% of people felt that corruption had become worse. Incidentally, globally 60% of all respondents felt that corruption had become worse. It is rather a grim picture.

Another source is the World Bank, which publishes governance indicators. Here, fortunately, we do not have the problem of making comparisons across time because the methodology is the same. If you look at the experience of six countries that have all been in conflict situations, it is interesting to see a different trend over the period 2002-2009. They have been relatively more successful in controlling corruption. The countries are Colombia, the Central African Republic, Croatia, El Salvador, Georgia and Serbia. So it is a mixed picture. One finds evidence based on perceptions that the problem is getting worse in some countries while in others the situation is getting better.

Leaving aside statistics, if you look simply at anecdotal evidence from around the world about what is happening, we in TI, with the knowledge we get from our national chapters, conclude that in many countries, even if corruption is still perceived to be a major problem by a majority of the citizens, there may still be a feeling that some reforms are taking place—or perhaps the public are becoming much more intolerant of corruption and, as we have seen in India, are taking to the streets to protest about it. The Arab spring vividly demonstrated that people are protesting not only about authoritarianism; their resentment of corruption was also a major reason for their public protests. We need to take all that into account in assessing whether things are getting better or worse. Clearly, corruption is a major challenge. If we take all the countries on the Corruption Perceptions Index, two-thirds of them score 5 or less. That is a grim situation.

Q487 Lord Moonie: A few countries receive substantial aid flows but still score relatively well on your index—Rwanda, for example, and possibly Ghana, with a score of 3.9, are prime examples in Africa. What lessons can we learn from these countries? Are their economic structures and systems of governance less prone to corruption? Are aid programmes to them designed differently?

Laurence Cockcroft: I will respond to that, if I may. The first point that I would like to make is that it is very doubtful that one can identify aid as a reason for an improvement in the reduction of corruption. In other words, I argue that it is questionable whether the fact that those countries have received aid necessarily has made them less corrupt. I will illustrate that by talking about individual countries. These two cases of Rwanda and Ghana are very different indeed. In the case of Rwanda, the very successful fight by President Kagame against small-scale corruption has certainly been effective. All the measures and polls that that are taken in Rwanda at the present time are very positive, in the sense that individuals are reporting a minimum of harassment from police and other services and the kinds of corruption that I was referring to a few minutes ago are much less. I think that this is attributable to a kind of Lee Kuan Yew effect, in which the head of state has been very effective in laying down the law. Obviously there is an attempt to build democracy in Rwanda, but it is very difficult and, as I am sure everyone here is aware, the system is very centralised, although there have been reasonably regular elections. There is also a very complex factor in Rwanda, which is that the governing party also draws a lot of funding from a company that is what one might call secret; it is certainly not very transparent. Secondly, the regime in general has, since it took power, in different ways been associated with the mining of coltan in eastern DRC, which has certainly provided some elements close to the regime with a useful source of income. So at the very top, the situation is rather murky and one cannot give Rwanda a really clean bill on that account. One can say that President Kagame has been very effective in relation to small-scale corruption of the kind that I mentioned.

I think that the situation in Ghana is completely different. Ghana has been independent for 54 years. These days it has a rather flourishing civil society. Ghanaians feel that they have been through a lot in the last few decades. In the 1970s, Ghana was in an absolutely terrible state under various military Governments, but I think that there is a kind of maturity in the Ghanaian civil society system and to some extent in the political system which is now, if not holding corruption in check, then at least holding it back, and which has helped to create a climate in which there is less corruption than there was because of this, as it were, political development. Although I do not think that past President John Kufuor was in any sense innocent of corruption, especially when it comes to party-political funding, I think that we can see that the Ghanaian public are quite focused on this issue, which will probably continue to be the case. An arrangement that President Kufuor had made with a US company in relation to offshore drilling has now been very much thrown into doubt as a result of public protest. So those are the internal dynamics in Ghana. Ghana has been assisted through aid flows for governance purposes, but I would not argue, and I do not think that TI would argue, that that has been the key factor. We have in Ghana quite a flourishing TI chapter, which has taken a stand on these issues, but it is to be seen in a broad context of a relatively well organised or rather mature civil society.

Q488 Lord Best: Donors use a variety of financing instruments in paying out their aid. There is direct budget support, contributions to special programmes, such as GAVI—the Global Alliance for Vaccines and Immunisation—which has had a very good press from previous witnesses, and direct off-budget project financing. Do any of these in your view lend themselves more or less to corruption? Are they more or less vulnerable to corruption?

Chandrashekhar Krishnan: Perhaps I may answer that question. For us in TI, the starting point is to do an assessment of corruption risk. In our view, that is what donors should do before deciding what modality to use in giving aid. Clearly in countries where governance is very weak and corruption levels are very high, and where public financial management is unsound, it would not make sense and would be undesirable to put a lot of money through direct budgetary support, whether to the central treasury or whether it is sectoral—say to an education ministry or a health ministry. Donors in situations like that are better off channelling aid to bypass government systems and perhaps to rely more on competent non-governmental organisations or contract other organisations to deliver the aid. On the other hand, in countries where the corruption risk is perceived to be less, direct budgetary support may be a more effective way. It is interesting that the report of the Independent Commission for Aid Impact has noted that, in the case of high corruption risk countries like Nigeria, for example, DfID does not provide any direct budgetary support, which in our view is the right thing to do. In the case of Bangladesh and Nepal, which are also high risk, the percentage of direct budgetary support is very small. Again, I think that that makes a lot of sense. On the other hand, in the case of Zambia, which is better in terms of public financial management, or perhaps India, a greater percentage of DfID aid is provided through direct budgetary support. The key thing is assessing corruption risk and then deciding the correct modality. If a donor is providing aid through multilateral channels, as the UK does—I think that about 35% of UK aid goes through multilateral sources—obviously it has less control but it is still possible to ensure that, whether the aid is going to the World Bank or to the Asian Development Bank, proper procedures are in place and that the aid is used for its intended purposes. If in high corruption risk situations donors are always bypassing local government systems, the question is then posed: what happens in the long run? Should you not put in place some capacity-building programmes to try to improve public financial management and public procurement processes? To us, that makes sense. While you are bypassing those government systems in the short term, you should put in place at the same time capacity-building programmes to build up those systems in the medium to longer term.

Other approaches that we in TI think are working and should be relied on more are measures to increase budget transparency and to track expenditure as it is disbursed through various programmes and making much better use of civil society and community organisations in monitoring budgets and in auditing expenditure. In many countries it is interesting that, where you have a right-to-information law, that is being used by community groups very effectively. I think that donors can capitalise on that in countries such as India, for example.

TI has started a programme involving the use of what we call Development Pacts. Basically, these are agreements between government service providers, whether it is water and sanitation, education or health, and the local communities who are benefiting from those services. The objective is to make fully transparent the aid that is being provided and then to account for its use and audit it. We have found that these agreements are working well and we would encourage their use more widely by more donors. If you look at what DfID is doing, they are on the right track, but the critical thing is to spend more resources in doing the ex ante corruption risk assessment from which other things would flow. Maybe the problem right now is that not enough time is being spent on that risk assessment.

Q489 Lord Best: Are you advocates for using technical assistance where perhaps the financial transfers are rather dodgy?

Chandrashekhar Krishnan: That may well be an essential way of doing it in the short term. At the same time we would recommend that you try to build local capacity if you are in a long-term aid relationship, say in a fragile state.

Q490 Lord Hollick: Can we examine the question of bypassing in a little more detail? Some donors choose to bypass corrupt Governments and go through NGOs. Is that in your view an effective policy or do the NGOs then get into the position, rather as Médecins Sans Frontières reported recently, where they have to pay a substantial amount of money over in order to be present in that particular country?

Chandrashekhar Krishnan: Perhaps I may answer that question, too. Yes, I think that we face a challenge here also. We cannot assume that delivery of aid by NGOs will always be effective. That is for two reasons. One is that, as you pointed out, although the NGO may have a commitment to strong anti-bribery systems, it faces these sorts of pressures. Of course, in most OECD countries, the NGO cannot pay bribes because bribery has been criminalised. That includes UK NGOs now as a result of the Bribery Act. The other challenge is where you may be disbursing aid through partner NGOs in countries where corruption levels are high and those partners do not have anti-bribery systems; they may also have very weak financial management systems. That therefore means that your aid is still vulnerable to corruption. We recommend that NGOs themselves should adhere to high standards and should be required to have strong anti-bribery systems in place. Working under the auspices of British Overseas NGOs for Development, we teamed up with another NGO, Management Accounting for NGOs—MANGO—and have developed a set of principles and guidance for NGOs to counter bribery and corruption. It is a practical tool, which we think could be used by NGOs operating in high-risk environments, to ensure that their own systems reduce the risk that corruption would occur in their operations. But this is quite a challenging area. The Independent Commission for Aid Impact has recommended that DfID needs to do much more due diligence on non-state partners through whom it is disbursing aid in many countries, which it is not doing right now. I know that I am promoting a TI tool, but I think that the guidance that we have developed is a practical contribution to addressing that challenge. There is a lot to be done in improving financial management among many non-governmental organisations. Just as we are focusing on strengthening public financial management in governments, I think that civil society also needs that kind of help in many countries.

Q491 Lord Hollick: You have highlighted what Transparency International can do to help NGOs. Is there a case for having a transparency index for NGOs?

Chandrashekhar Krishnan: It is an interesting idea and certainly worth pursuing. I do not know whether there are other organisations that do something like this, focusing not simply on corruption but on broader transparency issues.

Q492 Lord Lipsey: When you uncover corruption or fraud, is it a good idea to withdraw or withhold aid from the perpetrators, or does that simply not work and divert the problem elsewhere?

Laurence Cockcroft: I will address that, if I may. One has to be robust and tough but, of course, this is not quite as easy as it sounds, because there are not many aid projects that are for one year only; much more typically they may be for three years. Further, in a big project such as a big dam or a long road, to take an easy case, it might be extremely complex to withdraw. I would like to draw your attention to a very interesting case—the so-called Lesotho Highlands Water Project, which involved the construction of a dam in Lesotho for water to be channelled to South Africa. This project was partly funded by the World Bank. In 1994, the attention of the World Bank was drawn to the fact that the Lesotho Government considered that the project manager, Mr Sole, might well be corrupt. The bank, because of the urgency of the project and because it could not envisage the suspension of any activity, declined to follow this up. As a result, the Attorney-General of Lesotho, Mr Maema, sued Sole in the courts and proved irrevocably that he had been responsible for fraud and that the fraud that he had committed was with 12 European contracting companies and one Canadian one. The position that the World Bank had adopted—"We can't afford to suspend any disbursements on this project"—was in retrospect an absolutely catastrophic decision, which the bank then spent a considerable number of years trying to get out of. I use that as an illustration to demonstrate how tricky this can be.

It is fair to say that, in the last couple of years in Kenya, DfID has suspended an education project and has in fact demanded some of the money back. The Norwegian Government did this recently with a forestry project in Tanzania. I think that it is fair to be tough, but one has also to recognise certain realities, in that, when a project is in midstream, this is much more easily said than done. One has to be tough; one can certainly have a specific audit and then take some action, but that action has to relate to the future—in other words, "We will never do another project like this"—rather than to the project in hand. That applies not in all cases but in some cases, for the reason that I have given.

There is also the question, of course, of what, if disbursements are suspended for the reason that fraud and maybe corruption have been detected, that means for the rest of the government system. That, again, is a rather tricky question. For example, if aid funding the education budget is withdrawn but for political reasons the Government does not feel that it can avoid funding education, which I think politically would generally be the case, that might increase resistance to corruption, because the Government would have to recognise the fact that it had to deliver at least to some extent on its education target. So these arguments can go both ways and are quite tricky.

The underlying point that is really worth making is that in these contexts all funds are fungible—in other words, aid money is there and is funding a certain activity, but generally speaking, in most developing countries of the kind that this Committee is concerned with, it is true to say that that means that aid frees the Government to fund something else. In our submission, we drew attention to the extraordinary purchase by the Uganda Government in February of this year of Russian jets worth $750 million. That is in a year when total aid flows to Uganda are maybe $1 billion-plus, so it is almost inconceivable that that military outlay could have occurred in the absence of aid flows.

Q493 Lord Lipsey: It is more than just complicated, isn't it? If you withdraw the aid, you may have a dual effect. Yes, you punish the person who has been ripping off the money but you also punish the people who were benefiting from the project. If, out of the money going to an education project, 80% was getting through and 20% was going into the pocket of the civil servant responsible for that bit of education, you would be making the beneficiaries of the 80% suffer if you stopped the aid.

Laurence Cockcroft: That is part of a broader argument. There is frankly not a ready answer to that question. In informal discussions with many people in the countries that we are concerned with, I found an extraordinary willingness to be tough with those at the top who are milking the system, but that is a slightly different point.

Q494 Lord Shipley: You spoke a moment ago about DfID undertaking due diligence. Your written evidence calls on DfID to strengthen its anti-corruption strategies and develop improved risk assessment and mitigation strategies. DfID is currently reducing its administrative budget. Is it realistic to expect it to achieve this at the same time as it reduces its spending?

Chandrashekhar Krishnan: Perhaps I may answer that. I will start by saying that we 100% agree with the assessment in the report of the Independent Commission for Aid Impact that—I will quote from the executive summary—"tackling corruption effectively should be a basic condition of UK aid and the issue requires even greater emphasis in DfID's programmes as spending in fragile and conflict-affected states increases". This should not be seen as an administrative burden or expenditure. If one sees anti-corruption as an integral part of one's development interventions in countries that need aid in order to lift the poorest out of poverty, it will be easier to envisage a scenario where one increases the resources devoted to proper corruption risk assessment and at the same time moves towards the attainment of the 0.7% target. People might ask whether this means that less money will go to the distribution of anti-malarial bed nets or whether fewer primary healthcare centres will be constructed. It is possible that in the short term one may see it as a trade-off, but that is artificial because one is investing in proper anti-corruption assessments in order to make aid much more effective. If one does not make that investment, the aid will not achieve its intended purpose. That is the way we see it.

Q495 Lord Shipley: Should anti-corruption work be contracted out to other organisations such as the National Audit Office or the Ministry of Justice? What should happen? How should it be done?

Chandrashekhar Krishnan: That would make perfect sense as long as the organisations to which the work is contracted out have the competence to carry out anti-corruption assessments properly. If that is seen as a more cost-effective way of doing it and would achieve the ultimate objective of disbursing aid on the basis of a very strong anti-corruption strategy, it would make sense.

Q496 Lord Shipley: In your evidence you talk about parliamentary debates in recipient countries. What is the evidence that there is a problem there? Logically, it would be good to have parliamentary debates. What is the problem that you are trying to solve? Have recipient countries refused to have such debates? What exactly would you change to achieve the objective?

Chandrashekhar Krishnan: Shall I answer that or would you like to, Laurence?

Laurence Cockcroft: I will answer that, if I may. It is an extraordinary fact at the moment that, in the majority of aid-recipient countries, very large chunks of aid, be they from DfID or other donors, are not subject to the kind of debate that the budget gets. In most countries that we are talking about, there is usually a normal budgetary process. In Commonwealth countries it is often based on the UK model. But in many cases the arrangements that are made with big donors like the World Bank and DfID are not part of the debate process. This is an extraordinary situation. I cannot imagine that in 1976 when we borrowed from the IMF it was not debated in the House of Commons. But these arrangements are made in a very tight circle between aid officials and officials in government ministries of finance in ways that it is then extremely difficult for parliamentarians to review. It is the reverse of transparent and effectively the reverse of democratic. The point is not to make a song and dance about this but simply to say that it is a very unhealthy situation in which significant inflows are coming into a country that are often decisive—and certainly important—for the economy. These inflows are Government to Government but not subject to democratic scrutiny. In a context in which there is a general interest in building up governance systems, in the framework of the discussion that we are having today, the response is, "Wait a minute. We don't want to see these flows subject to parliamentary debate". It would be considered politically risky. Indeed, the donors by and large would not be very keen on it.

Q497 Lord Shipley: Perhaps I may pursue that. Why would the donors not be keen on having recipient countries discussing the aid that they are receiving?

Laurence Cockcroft: Because a lot of these of these projects are complicated. They are the subject of a huge amount of research and analysis by consultants. A large dam project may be the result of several years of elapsed time and many more man-years of time. By and large, aid agencies are extremely reluctant to see that process "derailed", in some sense of the word, because there is then a parliamentary debate about whether it was a good idea in the first place. Of course, in a context where there is serious corruption that may or may not be related to the aid programme, government leaders themselves are extremely reluctant to make this subject to parliamentary discussion.

Lord Shipley: So, to be clear, do you think that DfID should always require a parliamentary debate in a recipient country?

Laurence Cockcroft: Yes.

Q498 Lord Lawson of Blaby: Perhaps I may I ask a quick supplementary question on this point. You say quite rightly that DfID needs to have an anti-corruption strategy and needs to strengthen it. Of course, having a strategy is only half the battle; you then have to monitor what happens on the ground to see that the strategy is working properly. What proportion of DfID staff are engaged in anti-corruption monitoring?

Laurence Cockcroft: I think numerically it is quite small. They are regarded as having some significance. Three different sections of DfID deal with that. I will ask Chandrashekhar to elaborate.

Chandrashekhar Krishnan: I think the problem, apart from the resource issue, is co-ordination and coherence. At the moment there is an anti-corruption team in DfID that does most of the policy work on anti-corruption. There is also a counter-fraud unit, which is the forensic part of DfID, and fraud liaison officers who are attached to country programmes and offices. It would appear that these three groups are not working closely enough; a silo approach is being adopted. More joined-up working would certainly lead to a more effective approach to anti-corruption. I will also point out that this raises a broader question about the need for co-ordination of anti-corruption across government. We have an anti-corruption champion in the form of the Secretary of State for Justice. I do not know the extent to which he and the Secretary of State for Development confer about how anti-corruption needs to be mainstreamed into UK overseas aid strategy. Similarly, there is a link to our policies to keep dirty money out of the UK. Money laundering is an issue. Often, it facilitates bribery and corruption in many countries that receive UK aid. My point is that we also need more coherence in our overall anti-corruption strategy, not just within DfID.

The Chairman: We can take that up with the Secretary of State when we meet him.

Q499 Lord Moonie: Perhaps I may follow up on that. Do they get the balance right between preventive work on corruption and detection? Do they do any preventive work?

Chandrashekhar Krishnan: I think DfID needs to invest more in preventive work. That means probably doing more analysis of sector-specific corruption in many countries where it operates and where it is not enough just to do a national assessment. If you are operating in the sectors of education, health, water and sanitation, you have greater interaction with government officials, which increases your corruption risk. That is something which you should be mapping more carefully. It may also be the case in a very large country that the corruption risks can vary across regions and from state to state. Again, you might need to do more detailed assessments, which are probably not happening now.

Q500 Lord Hollick: By chance, a gentleman called Joseph Stead is appearing in Committee Room 13 at five o'clock this evening. He is Christian Aid's senior economic justice adviser. In his introduction to his remarks, he says that this is not only about tackling corruption and capacities in developing countries; it is also about tackling the lack of transparency elsewhere, in tax havens and corporations. I went on to his website and found that—surprise, surprise—many of the tax havens are a legacy of the British Empire. You have to look at the other side of the capital flight, if you like. Is that issue being raised with DfID? Is it something that DfID is concerned about? I notice that none of these tax havens appears on your Corruption Perceptions Index.

Laurence Cockcroft: I will respond to that, if I may. It is a huge issue. A lot of the capital flight to which we alluded earlier ends up in those jurisdictions. The figures for the Cayman Islands are, as I am sure we all know, absolutely extraordinary in terms of the number of companies registered there. One estimate is that 800,000 companies are registered in the Cayman Islands. The scale of this is quite extraordinary. Global Financial Integrity, the entity to which I referred earlier, estimates total flows into so-called secrecy jurisdictions—that is the phrase that it prefers to use, but it refers to what we would all recognise as offshore centres—as $1 trillion a year, which is obviously a huge sum by any standards. Of course, the fact that the jurisdictions are partly secret, or at least very secretive, and it is often difficult to work out the real owner of a shell company, is a huge incentive and a very effective way of ensuring that the fruits of corruption are not used usefully in the way that I described earlier. There are losses all round. Our responsibilities as the UK in relation to this are extraordinarily high, but it seems to be the case that it is a question of responsibility without power, since we seldom look into this in any great detail.

There was a very interesting report by Mr Michael Foot, who had been the head of the Financial Services Authority published in 2010 about the whole relationship between the offshore centres and the UK, including the Crown Dependencies and the Overseas Territories. It concluded that there was quite a serious problem but that we should hesitate, because there were serious benefits to the UK economy, as all the sums deposited in those jurisdictions at some stage or other wound up in the City for reinvestment. So this is very complicated. A lot of the insurance premiums that reach Lloyd's are cycled initially through Bermuda, so this is a very tricky area, which, from a TI point of view, is undermanaged, under-researched and not really recognised. At the present time, one of our board members, Ms Helen Garlick, is the chief investigator and prosecutor of a case in the Turks and Caicos Islands, where the Government was suspended about two years ago by the Foreign Office on the ground that there was a very high level of corruption. She is trying to deal with the fact that the Government in that country has been very closely associated with corruption in different ways. But even TCI, small though it is, is also the recipient of some of these flows. This is a huge area and, from a TI perspective, I would thoroughly agree that it is a problem that we in the UK are, frankly, failing to recognise, but we need to do so.

Lord Hollick: Have you written anything on this?

Laurence Cockcroft: We certainly have readily available material.

Lord Hollick: Could we be provided with it?

Chandrashekhar Krishnan: Yes. Perhaps I may just add to that. We published a comprehensive report in 2009 looking at this issue of weaknesses in our defences against the proceeds of corruption coming from abroad. Many of the Overseas Territories are financial centres and have financial intelligence units, but they sadly lack the capacity to regulate their systems, so we recommended that either the UK Government should invest more in helping them to raise their regulatory standards or they need to stop acting as financial centres. Of course, that has economic consequences, because financial services activity is a major source of income other than that from tourism, so it is a challenge. The Foreign Office, as you probably know, is holding a consultation on the future of the UK Overseas Territories and it will address issues relating to financial management and governance, among others. We intend to make a submission to that consultation.

Q501 Lord Smith of Clifton: This is a look at corruption from a different perspective. Almost 40% of DfID's budget goes to multilateral agencies. How does their record of dealing with corruption compare with that of bilateral donors?

Laurence Cockcroft: The World Bank, which is the pre-eminent IFI or multilateral donor, has changed its position very considerably in the past 15 to 20 years. The issue at hand in the project that I described was in 1994, which preceded the commitment made by Jim Wolfensohn, who then became the World Bank President, to address corruption. He put it firmly on the World Bank agenda in different ways, including making it very clear that the fight against corruption was something with which the World Bank wished to be associated and adopting for the first time, from 1997, the principle of blacklisting companies that were found to have behaved corruptly or to have perpetrated any fraud in relation to any World Bank project—several hundred companies have now been blacklisted through that means. When he was succeeded by Paul Wolfowitz, this concern with corruption became even more intense. Wolfowitz initiated a series of moves to beef it up even further by setting up an internal agency, INT, which was and still is involved in reviewing individual projects as potential sources of corruption and even reviewing individual staff members of the World Bank as potential sources of corruption. This internal security system became very strong. I think it has been relaxed a bit under Zoellick, but none the less this is now very much an integral part of World Bank activity. Some very senior people in the World Bank will in speeches say that there is no such thing as development without addressing corruption, so the spirit is very much there and I think that it is fair to say that the bank has tried to address this. It has also attempted to get all the other IFIs, such as the Asian Development Bank and the African Development Bank, to share this concern, although we would say rather less successfully. The principles that the World Bank has adopted are theoretically adopted by the other multilateral donors but I would say not quite so effectively.

There is underneath all this a dilemma. All these organisations—and I do not think that the World Bank has ever really escaped this—have a lending target. As long as you have a lending target, you feel obliged to disburse. For many years—I cannot categorically state that this has changed—World Bank staff members were rewarded by the volume of lending for which they were responsible. I think that that explains how, in the past, a lot of World Bank projects have been associated with corruption, as is pretty clear for all the reasons that you are reviewing the issues today. So I think that it is a mixed story. All I would say is that it is true that, in spite of the problems that we have been discussing and others, bilaterals probably have more flexibility.

The Chairman: Gentlemen, I am very sorry; I have to go to give evidence to another Committee down the corridor. I was trying to work out when I would be summoned—and I have been summoned now. I will try to come back and will ask Lord Lawson to take the chair in my absence.

Q502 Lord Lawson of Blaby: I think that this has been extremely useful and that probably we will not need to carry on much longer. I would like to ask you—I think that it is my turn in the batting order—two questions. You pointed out in your evidence that corruption risks are higher in conflict-prone and fragile states, yet it is the declared intention of the present Government to focus a higher proportion of their aid on these areas. Does that concern you? In particular, what do you feel about the position of South Sudan, which is certainly a conflict-prone and fragile state?

Laurence Cockcroft: I think that it is fair to say that it will be very difficult to divert a larger proportion of aid to so-called frail and maybe failed states. There are some lessons from the two giant experiences in Iraq and Afghanistan, both for us and for the US. I think that it is now undeniable that mistakes were made on a colossal scale. One mistake, for example, was the excessive use of contractors to solve a particular problem. Certainly for both the US and UK the use of companies to solve a particular problem had huge implications. The easiest example is the use of security companies to protect US military logistics coming from Pakistan to Afghanistan. The companies have been paying off warlords to get the materiel through and the warlords in turn have been supplying the Taliban with weapons. So we can see that this is a tricky business. As I am sure some of your Lordships know, there is a very good report on that by the US Congress called *Warlord, Inc*. All this is in the public domain and is not disputable.

If we ask ourselves what the implications are of the gung-ho use of contractors and probably the excessive availability of easy money and apply that to the case you raised of South Sudan, certain lessons can be drawn. One is that it is essential, however difficult it may be, to build up a competent government machine. Although the level of skills in South Sudan is extremely modest, none the less it is clear that that has to be a priority. So, for example, instead of saying we will get a contractor of the Halliburton type to build a road from Malakal to Juba, it would be advisable to build up capacity within the Government to organise tendering systems, even if that means going more slowly.

The most dangerous area in all this is the defence sector, where the Government of South Sudan clearly is nervous about possible further invasion from the north and about conflict in the territory of Abeye, where most of the oil under exploitation is. We know from the build-up of defence forces that has been going on since before independence that the Government are very anxious to spend money in the military sector. This is a clear area where DfID and any other agency of the UK Government should be very wary that their aid is not being used in the spirit of fungibility to build up military expenditure. The two areas of building up capacity within government, even if that means going more slowly, and watching defence expenditure very carefully are key guidelines that are worth underlining.

Lord Lawson of Blaby: Of course, if we did what the Chinese do, we would get a British contractor to build the road to Juba. We would keep tight control on what was happening and they would probably get their road with rather less corruption, would they not?

Laurence Cockcroft: That is excellent as a short-term solution, but the longer-term implications are quite dangerous. If I may generalise, the Chinese factor in Africa is very important at the moment; there is no doubt about that. The Chinese have so far been playing to a different tune. We may see quite a reaction against that—or see the limitations of that—in governance. By that I mean governance within Africa and other parts of the developing world where the Chinese are active. I think that this may turn out to be a phase that will wind down.

Q503 Lord Lawson of Blaby: Interesting. I will come back to a general point. Do you think that the British Government are mistaken? A number of witnesses have said that you cannot build a nation by aid and that nation-building is not an appropriate thing to do. Are the British Government mistaken in saying that a higher proportion of our aid will go to fragile and post-conflict states?

Laurence Cockcroft: I would not like to lay this down as a formal TI position. I will simply say, from my own experience, that it is a very dangerous strategy. If we visualise the rebuilding of Somalia, if that moment ever comes, it is absolutely certain that it will be very dangerous indeed to invest large sums of money there until it is clear how the land lies. I would add something that is perhaps less true of Sudan, but applies to the putative case of Somalia. It is very tempting—this is another lesson from Afghanistan that is well documented—to say that because there are different interests from different warlord groups, we need to support each of them in order to buy them in to the process. That becomes very dangerous because, when the Government are formed, the warlords expect the trade-offs to continue. That is something that President Karzai has struggled with ever since he took office.

Lord Lawson of Blaby: As you see, Lord MacGregor is now back, so I shall hand the chair back to him.

Q504 The Chairman: I had a remarkably quick interview with the Committee down the road and am glad to be back. I am not sure whether a question has been asked about the point that you made in your evidence that the risks of corruption are highest in the construction, defence and natural resources sectors. We are very interested in that point. Have recent initiatives such as the Extractive Industries Transparency Initiative, the Natural Resource Charter and similar initiatives in the construction sector been effective in identifying, limiting and dealing with the corruption problem?

Laurence Cockcroft: We think that the effect varies. EITI can be regarded for the time being as a very significant success. The sign-up rate among countries is high. As your Lordships will know, there are three tiers for signing up to EITI. There are now about 11 countries in the top tier. That means that in those countries the companies involved have agreed to declare what they pay to the state, and the state has agreed to declare what it receives from the companies. There is an issue about whether the declarations are disaggregated. Will individual companies agree to say what they each paid or will their payments be aggregated with everybody else's so that they will become difficult to define? The issue has been going on for some time. It has been ameliorated by the Dodd-Frank Act in the US which, when it becomes fully effective, will require US companies to declare as part of their normal reporting to the SEC the revenue that they have paid to the state, project by project. This will include royalty payments as well as corporation tax and any other payments they have been made of one kind or another. Of course, this is now being considered by the EU Commission as a piece of legislation that all member states should adopt, which TI is very much in favour of. So broadly speaking EITI has to be seen as a successful initiative.

The Kimberley Process involving diamonds has had a very high profile. It was unique because De Beers has such a controlling interest in the world diamond industry, so it is not strictly speaking comparable to EITI. Many organisations in the process, including the originator, Global Witness, from which perhaps you have heard, are very disillusioned with the process because of the way in which the Government of Zimbabwe have defended the activities of freelance military people mining in eastern Zimbabwe. The Natural Resource Charter is at an earlier stage and one is not necessarily convinced that it will manage to reconcile the interests of local communities, multinational companies and Governments. That is an open question.

Broadly speaking, we in TI we have been very supportive of these sector initiatives. We believe that it is often easier to get companies in a particular sector to adopt anti-corruption standards, as has been the case with the EITI, than it is to get companies working with many different products or with differentiated products to adopt those standards. We are of the view that this kind of approach has future opportunities.

The defence sector indisputably has been very corrupt. TI UK has taken a lot of interest in this sector. We managed to bring together the 14 largest defence companies in the world—US and continental, and BAE Systems—for three different meetings. That led, I can confidently say, to an entity called IFBEC, which is concerned with business principles in the defence and aerospace sectors. It was for the reasons I mentioned earlier about the possibility of working by sector that we got involved in that. I have to say that the future of IFBEC is an open question. One cannot get too optimistic but at least there has been an agreement, IFBEC is functioning and companies are sharing whatever their ethical principles are with each other. In this case, the Government are not involved and we as an NGO have dropped out of the process. However, the initiative has a lot of potential. This is a rich area that is well worth focusing on. DfID has responded; the CoST project in construction reflects that and has made reasonable progress.

Q505 The Chairman: You referred to this as a rich area worth progressing with. A number of witnesses inevitably talked about the impact in African countries of new donors such as China. I understand that industries from China are not yet participating in these initiatives. Is there anything that donors, including DfID, can do to encourage the new donors to come on board?

Laurence Cockcroft: As a matter of fact, I think that there is. It is very significant, I think it is fair to say that, as a result of membership of the G20, which has a working group on corruption, China and India—I will talk about Russia in a minute—both passed foreign bribery Acts this year that made it a criminal offence to pay a bribe overseas. You may say that you will believe it when you see it, but all these things have to begin somewhere and it is a remarkable development. I know that, when questioned in the G20, the Chinese delegation said, "Well, it's something we agreed to do. Why are you drawing attention to it? We are members of the group and that's what we have done." Obviously there is a big question about how it will work out, but the fact that India has done the same is very encouraging. The perception is that Russia, which has done the same, is more interested in this in the context of membership of the WTO. None the less, these three BRIC countries—Brazil is already in the OECD Anti-Bribery Convention and has legislation that affects overseas bribery—are now involved. Five years ago those of us who were concerned by and followed these issues felt that there was a weakness. There was an OECD convention, but we knew that major players, notably the BRICs, were not part of it. That has now changed. I think we will have to work on that. To be fair to DfID, its people in Beijing attempted to persuade the Chinese to do this. It would really be useful if this could be taken up consistently at a high level; it would be a tremendous move. Now that we have a UK Bribery Act that is being implemented adequately, it is a really key area.

Q506 Lord Forsyth of Drumlean: What should DfID do to draw a distinction between an intolerance of corruption and the losses that are incurred in practical terms when you work in risky and dysfunctional areas?

Laurence Cockcroft: I would argue that the public are more savvy about this than meets the eye. At various times during our involvement, we in TI were asked about this at some length. For example when the tsunami struck Thailand and Aceh province in Indonesia, we were asked what we thought should be done about ensuring that the huge sums raised from the public were not dissipated in various forms of inadequate implementation. Some interesting polls at the time suggested that among the British public there was an extraordinary willingness to accept that a percentage of the money raised would be lost in whatever way. When there is a crisis, people's attitudes are a bit more relaxed than they are in relation to mainstream aid and regular grant-making to the countries that we are concerned with. There people are much less tolerant and we cannot do much other than institute a regime in which DfID constantly reiterates what it is doing. Ideally, I would say that working with recipient Governments it will be possible—it ought to be possible in a number of cases, certainly in a Commonwealth framework—to address the British public directly about the provisions that DfID either is or potentially in the future will be putting in place.

Lord Forsyth of Drumlean: Are you saying that a zero tolerance strategy is impractical?

Laurence Cockcroft: Yes.

Q507 Lord Moonie: You said that you opposed the Government's commitment to spend 0.7% of GNI on aid on the grounds that it might lead to evasion of the issue of the impact of corruption on development. Is that less likely to get worse if the Government enshrines the 0.7% target in law?

Chandrashekhar Krishnan: Perhaps I may answer that. Probably what we said in our written submission was not clear enough. It is not that we are categorically opposed to the 0.7% target. Our concern is if this is seen as an end in itself—if it leads to a frantic rush simply to reach the target and the corruption issue is set aside. Laurence mentioned the problem of multilateral development banks, where there is a pressure to disburse to meet lending targets. That same mentality could take root in the UK and that would be wrong. If this is the scenario that is envisaged, we are very concerned about the 0.7% target and about enshrining it in law, which would commit the UK Government in perpetuity. On the other hand, if, as we believe is possible, the objective is to attain the target and then maintain it while doing much, much more to address corruption risks effectively—and I hope that in the course of this afternoon we have explained where we stand on that important issue—this target becomes more realistic. So ours is a more cautious approach. It is not categorical opposition to the target, but I think that it is very important that the corruption issue is seen as an integral part of a strategy for attaining it.

Lord Forsyth of Drumlean: But it is categorical opposition to enshrining it in law.

Chandrashekhar Krishnan: I think that that would give the UK less flexibility in ensuring that it is putting enough resources into anti-corruption. The danger is that, once it is enshrined in the law, that pressure to disburse, regardless of what is happening in terms of corruption on the ground, could become a serious problem.

Q508 The Chairman: Do you think that overall DfID is putting in enough resource to the anti-corruption drive? Also, do you think that the general public are convinced that this is an important part of the programme?

Chandrashekhar Krishnan: I think that DfID itself acknowledges that it needs to do much more. It would probably like to have more resources made available to it to invest more in anti-corruption. Certainly, much more needs to be done to explain to the UK public what is being done to address corruption risk. I do not think that it is being explained sufficiently, which probably explains why we are seeing declining public support for aid. It is also important to explain the other strategic reasons why the UK is providing development assistance. Certainly the goal is to help the poorest people in the poorest countries and to attain the millennium development goals, but there are also other strategic objectives, which relate to national security, for instance, and I do not think that that argument is being put forth with the clarity that it deserves.

Q509 Lord Lawson of Blaby: At the end of your very interesting written evidence, you list seven specific recommendations to strengthen DfID's approach to anti-corruption. Could you please let us have a short note listing, for each of those seven areas, how you rank the progress that has been made so far from zero to 10?

Chandrashekhar Krishnan: You do not want us to do it right now, do you?

Lord Lawson of Blaby: No, I want a piece of paper on which you give marks out of 10 for the progress so far on each of these seven points, which are interesting and important.

Laurence Cockcroft: We would be pleased to do that.

The Chairman: We have not gone into the recommendations as thoroughly as we perhaps should have done, but it would be very interesting to have that list. It will certainly be something that we will look at further when we come to do our report. Thank you very much. I think that you will be aware that the anti-corruption drive has been an important part of the evidence that we are taking and it is certainly an area that our Committee is very interested in. I repeat that I think your paper was most helpful to us in that regard, not least the recommendations. This has been a very helpful session this afternoon. Thank you both for that and for being here. There are a number of issues that we have asked you to follow up in a written report and we would be grateful to have that as soon as possible. Thank you very much.

Transparency International UK (TI-UK)—Supplementary written evidence

1. TI-UK had the pleasure of providing oral evidence to the House of Lords Select Committee on Economic Affairs on 13 December 2011. The Committee requested TI-UK to provide supplementary information on certain points to assist its Inquiry. This information is provided below.

Methodology of TI's Corruption Perception Index (CPI)
2. A note that summarises the methodology of the CPI is attached.

Illicit financial flows from developing countries
3. The US-based organisation Global Financial Integrity (GFI) has researched and published comprehensive data on illicit financial flows from developing countries. Its most recent report, "Illicit Financial Flows from Developing Countries over the Decade Ending 2009", published in December 2011, estimates the developing world lost US$8.44 trillion over the decade ending in 2009, or $723-844 billion per year during this period. According to GFI, leakages through balance of payments as a result of the illicit transfer of the proceeds of bribery, theft, kickbacks and tax evasion have been increasing relative to trade mispricing. On balance, these leakages accounted for 46.1 % of cumulative transfers of illicit capital during 2000-2009. GFI has also published a report on 'The Absorption of Illicit Flows from Developing Countries 2002-2006' in which it points out that the problem of absorption of illicit financial flows is one that rests primarily with Europe and North America.

4. TI-UK has been particularly concerned about the proceeds of bribery and corruption entering the UK's financial system because of weaknesses in its anti-money laundering (AML) regime and weak financial regulatory capacity in UK Overseas Territories (OTs). Its 2009 Report, 'Combating Money Laundering and Recovering Looted Gains'[444] (a copy is attached) made several recommendations for strengthening the AML regime, particularly through enhanced due diligence by financial institutions on Politically Exposed Persons, stronger financial regulations in OTs and disclosure of the beneficial owners/beneficiaries of trusts.

5. TI-UK continues to believe that there are serious challenges that need to be addressed in relation to some of the UK OTs that are offshore financial centres. They are constitutionally not part of the UK and in some of them, the Governor General is accountable for financial services. All the OTs have implemented AML regimes. They have Financial Intelligence Units (FIUs) and are members of the Egmont Group.

6. However, some of the smaller OTs have extremely limited regulatory and law enforcement capacity. This makes it difficult for them to address money laundering risks effectively. This vulnerability has serious implications for the UK's reputation. Recent developments in The Turks and Caicos have highlighted the problem. Michael Foot's 2009 Review of the opportunities and challenges facing the British Crown Dependencies and six OTs also highlighted some aspects of this vulnerability (this Review was commissioned by HM Treasury).

[444] http://www.transparency.org.uk/publications/101-2009-publications

7. TI-UK believes that the Government needs to continue to work with the vulnerable OTs to ensure that each has a regulatory capacity that is commensurate with its financial centre operations; and that practical training and technical assistance are provided for this purpose. But in some OTs, where the UK Government is responsible for financial affairs, the Government may be confronted with a choice - either a clear decision is needed to encourage the winding down of the financial centre, or a concerted effort is needed to support an increase in capacity for regulation, policy analysis, law enforcement and international cooperation. It would be dangerous to let the present status quo continue.

8. The UK should work with other partners, particularly through the G20, to curb illicit financial outflows from developing countries as well as ensure that the UK and other major financial centres do not absorb and benefit from these illicit outflows. This requires action by the G20 and other countries in several areas: enforcement of laws against foreign bribery and money laundering; mandatory reporting of payments made by extractive industry companies to governments on a country-by-country and project-by-project basis; making tax evasion a criminal offence as well as a predicate offence of money laundering (where this is not already the case); and also tackling the problem of trade mispricing and tax avoidance, which are more complex issues.

Assessment of DFID's performance

9. The Select Committee asked TI-UK to assess DFID's performance on a scale of 0 to 10 (where 10 represents best performance) in implementing the specific recommendations made by TI-UK in para. 18 of its written submission to the Committee. TI-UK's assessment is as follows (the text of each TI-UK recommendation is reproduced in full):

I. In any country assessed as having a high risk of corruption, DFID working with other donors, including the IFIs in which it is a major shareholder, should develop an explicit anti-corruption strategy.
Score: 5/10
DFID has initiated important general policy work in this area but this needs to be scaled up and integrated into DFID's aid delivery at the country level.

II. DFID should be proactive in assessing and mitigating corruption risks. It should review the structure and nature of its counter-fraud and anti-corruption resources and develop a more co-ordinated approach to risk assessment, risk management, anti-corruption programming and fraud response taking into account the UK institutions which can collaborate with aid recipient governments in tracking funds and freezing assets where appropriate.
Score: 5/10
There is considerable scope for improving risk assessment and coordinating the various parts of DFID that contribute to its anti-corruption strategy.

III. The Government's current Anti-Corruption Champion, the Secretary of State for Justice, and the Secretary of State for Development should work more closely to ensure that a coherent, co-ordinated approach to tackling overseas corruption is integrated fully into the UK's overseas aid strategy.
Score: 3/10
It is essential for the Anti-Corruption Champion to work more closely with DFID and other parts of government that are involved in aid delivery, anti-corruption work and law enforcement.

IV. Building on its Fiduciary Risk Assessments, DFID, with its partners, should undertake country financial accountability and procurement assessments and develop credible, time-bound action plans for reform of budgeting, accounting, audit and procurement systems. This would build on the existing Public Expenditure and Financial Accountability programme that DFID, the World Bank and other donors support.
Score: 7/10
DFID has made considerable progress in this area and needs to build on this.

V. All civil society organisations (CSOs) through whom development assistance is disbursed, should be required to adhere to a common verifiable standard for monitoring and auditing their use of aid monies. CSOs should also have robust internal systems for countering bribery and corruption. TI-UK and other partners in BOND have developed NGO Principles and Guidance for Countering Bribery[445], which can assist CSOs in developing such systems.

Since this recommendation is addressed to CSOs, we have not made an assessment. However, we recommend that DFID should require all its CSO partners to have robust internal anti-bribery systems.

VI. All aid funds should be recorded in recipient governments' budgets and subject to legislative and other oversight mechanisms. The transparency of public income and expenditure management, all aid transactions and the related monitoring systems should be increased.
Score: 5/10
DFID should be more rigorous and vigorous in requiring these standards to be met in aid recipient countries.

VII. In accordance with the International Aid Transparency standard, UK and other donor aid budgets should be presented in a transparent way so that the public in both the donors' and recipients' countries know the precise nature of commitments and disbursements.
Score: 8/10
The UK ranks among the world's most transparent aid donors and has played a leading role in pressing for greater transparency among donors. This is very welcome.

December 2011

Short methodological note

Data Sources:

- The Corruption Perceptions Index (CPI) 2011 is an aggregate indicator calculated using data from 17 sources provided by 13 reputable institutions. All sources measure the overall extent of corruption (frequency and/or size of bribes) in the public and political sectors, and all sources provide a ranking of countries, i.e. include an assessment of multiple countries.

445 http://www.transparency.org.uk/publications

- The CPI 2011 brings together data from sources covering the past two years. For the CPI 2011, this includes surveys published between December 2009 and September 2011.
- The sources used in the CPI 2011 draw on the perceptions of both resident and non-resident experts and are a mixture of business surveys, assessments by commercial risk analysts and country experts from international institutions.
- In the CPI 2011, the following nine sources provided data based on expert analysis: African Development Bank, Asian Development Bank, Bertelsmann Foundation, Economist Intelligence Unit, Freedom House, Global Insight, Political Risk Services, the World Bank and the World Justice Project. Four sources for the CPI 2011 reflect evaluations by resident business leaders of their own country: IMD, Political and Economic Risk Consultancy, Transparency International's Bribe Payers Survey and the World Economic Forum.
- For CPI sources that are business surveys, and where multiple years of the same survey are available, data for the past two years is included. This applied to the IMD, Political and Economic Risk Consultancy and the World Economic Forum, where surveys from both 2010 and 2011 were included.
- For sources where scores were provided by experts (risk agencies/country analysts), only the most recent iteration of the assessment is included.

Steps to calculate the CPI:

1. The first step to calculate the CPI is to standardise the data provided by the individual sources (that is, translate them into a common scale). We use a matching percentiles technique which uses the ranks of countries as reported by each individual source. This method is useful for combining sources that have different distributions. While there is some information loss in this technique, it allows all reported scores to remain within the bounds of the CPI, i.e. to remain between 0 and 10.
2. The second step consists of performing what is called a beta-transformation on the standardised scores. This increases the standard deviation among all countries included in the CPI and makes it possible to differentiate between countries.
3. Finally, the CPI scores are determined by averaging all of the standardised values for each country. There must be three separate data sources available for a country to be scored and ranked.

Results:

- The CPI score and rank are accompanied by the number of sources, the highest and lowest values given to every country by the data sources, the standard deviation and the confidence range for each country.
- The confidence range is determined using a bootstrap (non-parametric) methodology, which allows us to interpret the precision of the CPI score of each country, based on the distribution of the source data. A 90 percent confidence range is then identified, where there is a five percent probability that the CPI score is below and a five per cent probability that the value is above this confidence range.

For a more detailed explanation of the CPI method please visit www.transparency.org/cpi

UK Aid Network—Written evidence

EXECUTIVE SUMMARY

This Submission has been prepared by the UK Aid Network, a coalition of UK-based development NGOs working together to advocate for more and better aid. It tackles questions 1, 4, 5, 6, 7, 10 and 12 outlined in the call for evidence.

- The positive relationship between aid and growth has been extensively documented, with Paul Collier estimating that over the last thirty years aid has added around one percentage point to the annual growth rate of the bottom billion. However, findings remain inconclusive, largely because of the complex nature of this relationship and the variety of factors at work. Furthermore ODA should therefore be judged in terms of recipient countries progress towards other goals such as poverty reduction and increasing human development, rather than economic growth, which is not its main objective.
- Over the last decade or so, donors have been engaged in a process of self reflection about how to make their aid more effective, leading to the agreement of a key set of principles aimed at improving the effectiveness of aid. These Principles are set out in the 2005 Paris Declaration on Aid Effectiveness (PD) and the 2008 Accra Agenda for Action (AAA), at the heart which is a commitment to put **ownership** at the centre of development assistance**, align** donor support to country strategies**, harmonise** donor procedures to reduce bureaucracy**,** as well **manage for development results** and build **mutual accountability.**
- Policy conditionalities all too often impede democratic ownership and undermine democratic accountability of Governments to their citizens. Campaigners in the developing world have therefore stressed the importance of phasing out policy conditionalities, with policies instead determined through democratic means within recipient countries. The UK Government's 2005 policy on conditionality represents a relatively progressive position, and has been welcomed by UK NGOs; however, the lack of monitoring or assessment of implementation of this policy means that a number of questions remain.
- There should be a focus on need as the main factor in determining aid allocations. One of the most prominent measures of need that has been utilised in recent years is the Millennium Development Goals, which present both opportunities but also limitations in ensuring that ODA is allocated to where it can have most impact on the neediest.
- The financial crisis has caused the financial conditions facing developing countries to deteriorate sharply, meaning that developing countries are currently being forced to operate at well below their absorptive capacities. The importance of increasing levels of official development aid in such a climate is clear. The UN target for rich countries to give 0.7% of GNP in ODA acts as an important mobilising symbol for global aid, and is a crucial step towards meeting these funding shortfalls.
- UKAN recognises that development assistance does not occur in isolation from the UK's diplomatic and defence agendas, and that there is a need for 'policy coherence' across the UK Government. However, there is a danger that long-term investment in conflict-affected and fragile states is crowded out by shorter-term trade or security concerns. Such behaviour threatens to undermine wider commitments to effective,

needs-focussed international aid, and there is therefore a need to ensure that development assistance in remains governed by principles of need and aid effectiveness.

- UK Government has recently undertaken reviews of both its bilateral and multilateral aid, which represent an important attempt to improve the effectiveness of British ODA. However, there are a number of further steps that should now be taken if the British government is to improve the effectiveness of its development aid. These include improving monitoring & evaluation; retaining a broad understanding of pursuing value for money from aid, and meeting aid effectiveness commitments.

Question 1.

How far and in what ways does official development assistance (ODA) affect the economic growth of recipient countries? Where possible to identify, what has been the impact of British ODA? How robust are results from studies in this area?

1. How aid affects the economic growth of developing countries has been the subject of study for a long time. In 1972 and 1973 Papanek found a positive relation between aid and growth[446], as did Singh[447] (1985), Snyder (1993)[448] and Fayissa and El-Kaissy[449] (1999) subsequently. More recently, Paul Collier has reinforced this argument, estimating that over the last thirty years aid has added around one percentage point to the annual growth rate of the bottom billion; "Without aid, cumulatively the countries of the bottom billion would have become much poorer than they are today."[450]

2. At a less macro-level, the positive effects of ODA on economic growth can be seen in a wide range of areas, for example through investment in education. Although there are also many variables which affect the relationship between a child's education and their subsequent productivity, studies show that there is significant correlation between investments in education and subsequent, increased economic growth.[451] Spending on education has a direct effect on the accumulation of human capital, this increases the quality of labour, in turn increasing economic output and producing higher growth rates.[452] Aid invested in education is therefore not only a social good, helping to realise children's rights and meet Millennium Development Goal 2, but it makes economic sense.

[446] Papanek, G. (1972). "The Effect of Aid and Other Resource Transfers on Savings and Growth in Less Developed Countries." Economics Journal 82; Papanek, G. (1973). "Aid, Foreign Private Investment, Savings and Growth in Less Developed Countries." Journal of Political Economy 81, pp.120-130

[447] R Singh, 'State Intervention, Foreign Economic Aid, Savings and Growth in LDCs: Some Recent Evidence' Kyklos (1985) Vol 8, Issue 2.

[448] Snyder, Donald W. (1993). "Donor Bias Toward Small Countries: An Overlooked Factor In the Analysis of Foreign Aid and Economic Growth." Applied Economics, 25, 481-488

[449] Fayissa and El-Kaissey (1999), 'Foreign Aid and the Economic Growth of Developing Countries (LDCs) Further Evidence' Studies of Comparative International Development Vol 34, No. 3, 37-50.

[450] Collier, P. (2007) 'The Bottom Billion', p100

[451] Blankenau, 'Public Schooling, College Subsidies and Growth' Journal of Economic Dynamics & Control 29 (2005) 487 – 507; Cullison, W., 1993. Public investment and economic growth. Federal Reserve Bank of Richmond Economic Quarterly 79, 19– 33

[452] Blankenau, W.F. and Simpson, N.B. (2004), "Public education expenditures and growth", Journal of Development Economics, Vol. 73, pp. 583-605.

3. However, other academics have tried to critique these positive arguments, claiming that aid has a negative impact on growth as it erodes institutional quality, increases rent-seeking and corruption[453]. It is certainly true that the academic debate on the relation between aid and economic growth remains inconclusive, largely because of the complex nature of this relationship and the variety of factors at work. Economic growth is first and foremost the product of the internal political dynamics of recipient countries, and is influenced by a plethora of financial flows; it is therefore unrealistic to single-out and assess aid as if it were an isolated driver of growth.

4. Furthermore, economic growth is neither the sole, nor even the main, objective of official development assistance. Nominally at least, aid is focussed on other goals such as poverty reduction and increasing human development; its impact should therefore be judged in terms of recipient countries progress towards the achievement of these goals, rather than economic growth. Growth alone will not end poverty, and when growth is measured in terms of the average increase in income per capita, we often miss the fact that large parts of the population – those from a certain geographic area, or socio-economic group, for example – may not be sharing in its benefits. Examples of this include India's rapid growth, which has not significantly benefited the poorest 40% of rural households[454].

Question 4.
What factors determine the effectiveness of ODA in recipient countries? Are they dependent on the scale and form of aid flows? How is aid effectiveness monitored?

5. Over the last decade or so, donors have been engaged in a process of self reflection about how to make their aid more effective. This process led to the 2005 Paris Declaration on Aid Effectiveness (PD) and the 2008 Accra Agenda for Action (AAA), in which donors agreed to a key set of principles and a programme of reforms aimed at improving the effectiveness of their aid. These agreements are the most comprehensive international attempts to date to define principles of effective aid, identify a wide set of reforms to put these principles into reality, and agree a range of measurable targets to measure progress on these reforms.

6. At the heart of the Paris Declaration is a commitment to put **ownership** at the centre of development assistance**, align** donor support to country strategies**, harmonise** donor procedures to reduce bureaucracy**,** as well **manage for development results** and build **mutual accountability**. A consensus has emerged that reforms in these areas are critical to making aid more effective, in large part due to increasing awareness of the negative effect that previous types of practices have on the impact of aid; the rationale and evidence for each principle is outlines briefly below:

A) Ownership

7. The extent of country-ownership of development strategies is recognised as the key determinant of the effectiveness of ODA, and the positive returns of coordinated,

[453] Knack 2000
[454] Save the Children (2010) Children and Economic Growth

country-led and sustained donor support to capacity building are perhaps nowhere better testified to than in Rwanda. In 1988 the Government of Rwanda used a grant of £20 million from the UK government, to set up The Rwandan Revenue Authority. Since then the UK and other donors providing support have helped to build the capacity of the revenue authority to the point where it now collects the value of that original grant every four weeks and aid dependency – though still high – is falling.

B) Alignment

8. In order to promote country-owned development policies and strategies donors must ensure that they are doing all they can to align their support to local efforts, including by ensuring their aid is recorded in national budgets, putting aid through local systems (the most progressive approach to doing so being budget support) and avoiding using parallel ones. In this way, **the form of aid flow** has an important impact on the effectiveness of ODA. Specific factors relating to alignment that determine the effectiveness of ODA and are addressed by Paris and Accra include:

Untying aid

9. Studies on tied aid (aid tied to the buying of goods and services from donor countries) suggest that, due to the higher cost of procuring from donor countries and not competitively from the cheapest source, this form of aid leads to over-pricing of goods and services purchased by aid by 15-40%[455]. This analysis suggests that simply by the untying of at least $5 billion of bilateral aid between 2005 and 2007[456] donors will have increased the real value of this aid by between $0.8 billion and $2 billion. Given that in 2008 approximately $32 billion of OECD aid was tied[457], delivering the same volume of aid but untying it fully would increase its real value by between $5 billion and $13 billion or between 4% and 11%.

Making aid flows predictable and reliable

10. A 2008 study by Homi Kharas[458] suggests that due to the impacts of aid volatility and unpredictability on inflation, exchange rates, fiscal policy, and uncertainties in investment levels, current levels of aid predictability reduce the value of aid by 15%-20%. This analysis suggest that the simple improvement of in-year predictability in aid by 5% between 2005 and 2007[459] has increased its real value by a significant amount, and delivering existing levels of aid on time as promised would literally add $10-20 billion to the real value of this aid.

Budget support & use of country systems

11. The current consensus around how to deliver aid emphasizes the importance of donors moving away from delivering aid through a multitude of projects towards support for national development programs (called Program Approaches), including

455 "Real Aid – An Agenda for Making Aid Work", Action Aid 2004
456 "2008 Survey on monitoring the Paris Declaration", Table B.8, page 93, OECD, 2008
457 Based on the following calculations:
- The OECD's 2010 Development Cooperation Report states that $11.6 billion of OECD aid excluding technical cooperation, food aid and admin costs was tied
- Actionaid's Real Aid Reports suggests that ¼ of total aid - $30 billion in 2008 - is technical cooperation; a recent OECD Report, "Untying aid: Is it working?" found that 60% of technical cooperation is effectively tied; tied technical cooperation in 2008 was therefore equivalent to $18 billion
- ¾ of food aid is estimated as tied; food aid was $3 billion in 2008, so $2.25 billion was tied

458 "Measuring the cost of aid volatility", Homi Kharas, Brookings, July 2008
459 "2008 Survey on monitoring the Paris Declaration", Table B.7, page 92, OECD, 2008

through delivering aid directly to government budgets (called Budget Support). Both general and sector budget support (aid going to the budget but solely to one particular sector e.g. health or education) have had a positive, demonstrable impact upon the delivery of essential services; by lessening the bureaucracy associated with receipt of aid funds, freeing up time and resources for more judicious investment and improving national planning and budgeting processes. DFID country offices using budget support were twice as likely to report improved access to services over a five year period compared to country offices not using budget support.[460]

12. In 2008 Oxfam and the European Commission undertook an evaluation of the impact of the Commission's general budget support. In eight of the largest country recipients of budget support government spending had increased by nearly a third. Apart from one country, all experienced an increase in children's primary school enrolment. One outstanding example is Madagascar where the number of children enrolled in primary education increased from 69% to 92% in one year.[461] An ODI study of 10 sectors in 5 African countries demonstrated that the use of sector budget support led to i) more support for the expansion of service delivery ii) improved planning and budgeting and financial management, ii) more predictable aid flows and iii) improved policy implementation with strengthen government accountability and ownership of policies.[462] Similarly the introduction of free basic services, primary education in Rwanda, Uganda and Mali and free basic healthcare in Zambia, as a result of sector budget support has increased demand and service uptake; in Uganda and Rwanda there was a notable expansion in primary education following the provision of sector budget support.[463]

Transparency

13. There is a strong relationship between better information about aid and delivering aid effectiveness. Governments in recipient countries struggle to know with precision how much aid is invested in their country, from whom, and how it is being spent.[464]

14. The issues here are two-fold: a lack of funds means that plans cannot be implemented, whilst a lack of predictability or future aid information means that government officials invest less in future planning processes. Donor 'fickleness' is, unfortunately, not an uncommon experience for recipients.[465] At the macroeconomic level, not knowing how much external aid is flowing into a country undermines macro-planning and stability thus affecting exchange rates, monetary supply and fiscal policy, potentially making poverty reduction harder to achieve.

15. Improving the transparency of aid is essential for the efficient and effective use of resources, to enhance the quality of both planning and decision-making processes and subsequent implementation. Weak aid transparency as well as planning and implementation deficiencies also undermine evaluation and learning at both the

460 NAO survey of DFID country offices

461 Fast forward- How the European Commission can take the lead in providing high-quality budget support for education and health

462 Tim Williamson and Catherine Dom, 'Sector Budget Support in Practice Synthesis Report' ODI February 2010 pg x-xi.

463 Ibid, pg 12.

464 Within recipient governments the issue around lack of aid transparency has an impact on line ministries and agencies, as well as oversight bodies such as prime minister's or cabinet offices, ministries of finance, audit institutions, etc.

465 Celasun, O. and Walliser, J., "Predictability of aid: Do fickle donors undermine aid effectiveness?", Economic Policy, July 2008, pp. 545–594.

technical and political level. It is not possible to evaluate a programme's effectiveness or efficiency when a significant proportion of resources in a sector or region remain unknown.

16. Greater aid transparency has significant benefits: more effective **allocation and management** of aid, better recipient government **planning**, increased **accountability** of donors and governments in the North and South, reduced risk of **corruption** and enhanced public **participation**. These factors are essential foundations for meaningful analysis of the impact of ODA and ultimately for generating sustainable economic growth.

C) Harmonisation

17. Before 2005 donor assistance was blighted by poor coordination and burdensome levels of associated bureaucracy which significantly reduced the effectiveness of ODA; a study on Tanzania found that reporting to poorly coordinated donors took up 40-50% of the time of District Medical Officers, while hosting took another 10-20%[466]. In 2009 a report by the European Commission[467] suggested that the administrative costs to EU institutions of fragmented and uncoordinated aid reduced its value by 3%-6%. If this was assumed to be common of all donors, delivering the current level of OECD aid through coordinated efforts would increase the value of it by between $4 billion and $7 billion.

18. Programme-based approaches[468], including sector-wide approaches[469], and pooled funding arrangements have been highlighted as means of pursuing coordination. Through the use of programme-based approaches donors contribute to funding a set of development activities at the national, sectoral, sub-sectoral or thematic level. The most common method is to make funds available to support the development and implementation of a single country-led strategy, often through general or sector budget support.

D) Managing for Development Results

19. Managing for development results (MfDR) is a management strategy that focuses on using performance information to improve decision-making, including the use of practical tools for strategic planning, risk management, progress monitoring, and outcome evaluation. The Paris Declaration commits donors and recipients to increase their use of such approaches.

E) Mutual Accountability

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466 WHO (2007) "Aid Effectiveness and Health", WHO Working Paper 9, 2009

467 "Aid Effectiveness Agenda: Benefits of a European Approach", EC, October 2009

468 The OECD-DAC definition of PBAs is aid that shares the following features: (i) leadership by the host country or organisation; (ii) a single comprehensive programme and budget framework; (iii) a formalised process for donor coordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement; and (iv) efforts to increase the use of local systems for promoting design and implementation, financial management, monitoring and evaluation.

469 The OECD DAC definition of SWAps is: All significant donor funding support a single, comprehensive sector policy and independent programme, consistent with a sound macro-economic framework, under government leadership.

20. More important than commitments on aid reform is actual implementation of these by donors and recipients. ODA is more effective where donors and recipients have established processes for promoting their accountability to each other for meeting their commitments. Such processes are also critical to efforts to promote more equitable aid relationships, as traditionally the focus of accountability for aid has been on recipient accountability to donors, with donor accountability to recipients weak or non-existent.

Aid Effectiveness in Fragile States

21. The countries, sectors and groups facing the most acute development and humanitarian needs are all too often also those facing challenges of conflict and fragility. To guide and support donors to deal with the some of the unique challenges faced in delivering aid in these contexts a separate set of Fragile States Principles (FSPs) have therefore been developed with aid recipients. These aim to compliment the Paris and Accra principles and work together with them to produce a comprehensive and specialised agenda for promoting aid effectiveness.

22. Originally drafted in 2005 and adopted by OECD ministers in 2007 the FSPs include: 1) Take context as starting point; 2) Ensure all activities do no harm; 3) Focus on state building as the central objective; 4) Prioritise prevention; 5) Recognise the links between political, security and development objectives; 6) Promote non-discrimination; 7) Align with local priorities; 8) Coordinate with other international actors; 9)Act fast…but sustain engagement over long term; 10) Avoid pockets of exclusion.

Question 5.
Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA? What has been the British government's experience?

23. Policy conditionalities – making aid disbursements conditional on the introduction of particular policies in a developing country - all too often impede democratic ownership and undermine democratic accountability of Governments to their citizens; as the 2005 Africa Commission noted *'Policy conditionality…is both an infringement on sovereignty and ineffective*' noted the Africa Commission in 2005[470]. Campaigners in the developing world have therefore repeatedly stressed the importance of phasing out policy conditionalities if the international community is serious about promoting developing country leadership, ownership and nationally owned development processes.

24. Of course this does not mean that donors cannot require basic accountability from aid recipients or that they meet basic standards of commitment to poverty reduction, human rights and financial reporting to those they support – as DFID requires for its aid – but that the policies countries use to pursue their own development should be determined through democratic means in their countries. It may also be helpful to consider outcome-based targets as a condition for some of the aid delivered - the European Commission makes 20% of its budget support conditional on achieving health, education and poverty targets.

[470] Oxfam (2006) Kicking the Habit:, Oxfam Briefing Paper, November 2006, p 1

ic decision-making, to force poor countries to implement policies based on dogma and ideology rather than on evidence. Despite these problems they have been and continue to be applied by donors, with harmful implications. A recent Oxfam study illustrates some of the negative effects of economic conditionality in Mali, where, far from leading to economic growth and poverty reduction, conditions have hiked electricity prices and are likely to hurt cotton farmers as well as delaying aid flows and undermining country ownership of policies. The World Bank has deliberately prevented the Malian government from accessing more aid on the grounds of its failure to privatise its cotton industry, and as a result Mali currently receives at least $72m less than it could. This money could be used to pay the salaries of 5,000 teachers for the next ten years, in a country where only 17 per cent of women between 15 and 24 are literate[471].

26. The UK Government's 2005 policy on conditionality represents a relatively progressive position, and has been welcomed by the UK NGOs. This policy commits the UK Government to no longer apply conditions relating to privatisation and liberalisation and to make commitment to poverty reduction, human rights and financial accountability its basic pre-conditions for aid. In addition, its 2009 How To Note on this policy included further commitments to ensure policy conditions are country (not just government) owned and to make conditions public.[472] Despite this progressive policy there are major questions about its implementation as this has not been monitored nor assessed in any way.

Question 6.
How should ODA be allocated? How far do (and should) the Millennium Development Goals (MDGs) shape aid allocations?

27. The allocation of ODA should be based on consideration of the following factors:

Need

28. There should be a focus on need as the main factor in determining allocations, thereby ensuring the aid is focussed where needs are greatest and most challenging to address. One of the most prominent measures of need that has been utilised in recent years is the Millennium Development Goals, adopted by the international community in 2000.

MDGs

29. The MDGs present both opportunities but also limitations in ensuring that ODA is allocated to where it can have most impact on the neediest.

30. Firstly the value of the MDGs has been to provide clear, common and measurable targets around which all development actors can cooperate around. They also act as effective signals for ensuring aid is allocated to sectors in which progress is slow; for

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471 Ibid; p2

472 See UKAN's comments on DFID conditionality guidelines, July 2006 and UKAN response to the UK government's "2009 How-to-Note on Implementing the UK's Conditionality Policy", July 2009

example, UKAN members have been able to respond to the relatively slow progress towards some goals, such as MDGs 4 and 5 – on child and maternal health – with a greater focus on maternal and child health.

31. However the MDGs are equity neutral in the sense that the most logical way of meeting the goals is targeting groups in easy to reach populations for whom a small intervention can move them across the finishing line. There is a danger that the most vulnerable will be relatively neglected. In particular, the MDGs have, to cite the World Bank's World Development Report, 2011, have 'drawbacks in their direct relevance to progress in violence prevention and recovery'.

Stakeholder Consultation

32. It is at the country level that country needs can be best understood and responded to and country ownership mostly actively pursued, and it is therefore vital that the details of how ODA is allocated is linked with country efforts on the basis of extensive engagement with country governments, civil society organisations and wider stakeholder groups. Similarly, aid effectiveness principles and practices should play a critical role in decisions around where and how resources are best invested and the type of results that country programmes should pursue.

Question 7.
How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?

33. The financial crisis has caused the financial conditions facing developing countries to deteriorate sharply, with the World Bank estimating in 2010 that developing countries faced a financing gap of $270-$700 billion depending on the severity of the economic and financial crisis and the strength and timing of policy responses. They argued that, even at the lower end of this range, existing resources would appear inadequate to meet financing needs, and should a more pessimistic outcome occur, unmet financing needs will be enormous[473].

34. Such funding challenges will not be short lived; the financial crisis will have long-term implications for developing countries that now face declining revenue and rising unemployment, putting Government budgets are under even greater pressure. Sub-Saharan Africa faced a potential loss of around US$4.6 billion annually in financing for education in 2009 and 2010, equivalent to a 10% reduction in spending per primary-school pupil.[474] Not only does this pose a serious threat to progress in all areas of human development, it will also lead to slower rates of economic growth in future. Indeed, evidence for this can already be seen; growth in developing countries decreased from an average of 5.2% in 2008 to 1.2% in 2009, below the levels of population growth.[475]

[473] World Bank. (2009) *Swimming Against The Tide: How Developing Countries Are Coping With The Global Crisis* (Background Paper prepared by World Bank Staff for the G20 Finance Ministers and Central Bank Governors Meeting, Horsham, United Kingdom on March 13-14, 2009), p1
[474] UNESCO (2010). *Education For All Monitoring Report 2010; Reaching the Marginalised,* p1
[475] World Bank (2010) World Bank Global Economic Prospects 2010; Crisis, Finance and Growth

35. Developing countries are therefore currently being forced to operate at well below their absorptive capacities, and the importance of increasing levels of official development aid in such a climate is clear: aid is thought to currently provide the only source of fiscal flexibility – to support spending increases – in 11 sub-Saharan African countries, and to be critical to such efforts in another 14.[476]

36. The UN target for rich countries to give 0.7% of GNP in ODA acts as an important mobilising symbol for global aid, and is a crucial step towards meeting these funding shortfalls. OECD statistics show that, by 2010, official development assistance provided by DAC EU Members had increased by $13,980.24m since formal aid targets were agreed in 2005[477]; the UN target can therefore be seen to be playing a vital role in increasing peer pressure on governments to take up their share of the funding burden, and ensure that ODA levels continue to rise.

Question 10.
How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

37. UKAN recognises that development assistance does not occur in isolation from the UK's diplomatic and defence agendas, and that there is a need for 'policy coherence' in ensuring that the different arms of the UK government are working with rather than against each other in promoting development[478]. The aim of poverty reduction is in the long-term interests of the UK, such that developing nations become prosperous trade partners and stable, reliable international partners as we address a range of collective action problems inherent in globalisation.

38. Furthermore, many of the poorest and neediest people live in conflict affected and fragile states. Providing aid in conflict-affected and fragile states is essential, and it is vitally important that aid is invested in these countries. We accept that supporting fragile contexts can be more costly than engaging in more stable states. While the costs may be higher, we understand the benefits to be even greater – since as well as securing immediate benefits for the targeted population, we contribute towards a positive cycle of increasing stability, security, prosperity and ultimately less aid dependence in the future.

39. There is a danger, however, that long-term investment in such countries is crowded out by shorter-term trade or security concerns. A recent Oxfam investigation into the securitisation of aid found that "some donors' military and security interests have skewed global aid spending; and amidst conflict, disasters and political instability have too often led to uncoordinated, unsustainable, expensive and even dangerous aid projects". Such behaviour threatens to undermine wider commitments to effective, needs-focussed international aid, and there is therefore a need to ensure that development assistance in fragile states is not subsumed to security concerns, and remains governed by a number of key principles.

Security concerns should not trump need

[476] UNESCO (2010). *Education For All Monitoring Report 2010; Reaching the Marginalised*
[477] OECD.Stat Aid Statistics: http://stats.oecd.org/Index.aspx?DatasetCode=ODA_DONOR
[478] See World Vision UK commissioned paper by IPPR - Policy Coherence and the Future of the UK's International Development Agenda

40. Aid risks being security-driven if specific areas of fragile states where there is substantial humanitarian need are neglected in favour of other areas that are affected by conflict (e.g. central vs. eastern DRC; South Sudan vs. Darfur; Afghanistan[479]). Such a means of prioritising aid not only potentially contravenes a rights-based approach that prioritises those most in need of support; it is also a short-termist approach to stability. Similarly, the militarisation of aid and the use of the military in the delivery of aid can undermine the legitimacy and effectiveness of the development assistance. UKAN considers that the requirement that ODA be aimed at poverty reduction, as enshrined in the International Development Act, is an important safeguard against some of these concerns.

Focus on Aid quality

41. The quality of the aid provided is just, if not more, important than the quantity of support, as irregular or poorly directed aid can exacerbate instability. This means providing predictable, long term funding, both to countries that have emerged from conflict and those countries that are struggling to prevent an escalation of conflict. The priority in engaging in fragile states must be system strengthening, ensuring that legitimate and competent states emerge that are able to provide basic services for their citizens and so rebuild a social contract between state and citizen that promotes stability and prosperity. As such while the Value for Money agenda is legitimate in a time of fiscal constraints in the UK government, we must ensure that quick wins at low costs are not seen as greater value than more long-term, and potentially risky, investments. The Fragile States Principles – see response to question 4 fopr details - must also guide efforts to promote aid effectiveness in these contexts

Question 12.
In what ways, if any, can the British government improve the effectiveness of its development aid?

42. Commissioned by the new administration in 2010, the UK Government has recently undertaken reviews of both its bilateral and multilateral aid. These reviews represent an important attempt to improve the effectiveness of British development aid by tackling some of the challenges of the past, moving away from previous processes of aid allocation focused mainly on inputs, and instead considering the specific goals and outcomes that UK assistance can achieve. UK NGOs have warmly welcomed many of these changes; however, there are a number of further steps that should now be taken if the British government is to improve the effectiveness of its development aid:

Improve monitoring & evaluation

43. In recent years, a consensus has emerged that DFID needs to invest more resources in M&E, use more robust practices, make M&E more independent, link it better to policy, and be more open to learning (IACDI 2008 and 2009). The new Independent Commission on Aid Impact represents a welcome step towards a more robust and independent evaluation of British ODA across all departments, which will go some way towards addressing many of these concerns. However, it is also important to

[479] ODI (2011) 'Security, humanitarian action and development: navigating a shared space for international engagement in fragile states', p.3

ensure that this does not detract from DFID's internal evaluation capacity, nor reduce the space and opportunities for learning that exist within the organisation.

Retain a broad understanding of pursuing value for money from aid

44. DFID's recent work to better understand cost and efficiency issues and to promote value for money (VfM) from its aid is vital to equipping it to work more effectively in the future. However, it is important that DFID don't simply focus on a narrow cost assessments of different interventions to pursue VfM but take a more comprehensive approach to assessing VfM including understanding which approaches are likely to be more sustainable, promote country ownership better and target the very poorest people.

Meet aid effectiveness commitments

45. In order to compliment and guide efforts to deliver VfM a major priority for DFID is to meet its aid effectiveness commitments laid out in the Paris Declaration and Accra Agenda for Action and agree to more ambitious and wider future related reforms. The importance of the Paris and Accra frameworks lies in their highlighting the need for DFID programmes to support country development efforts as best they can in coordination with other donors, as well in promoting accountability and the results focus of aid. Where DFID's programmes fail to support country development processes and institutions, there is a danger that their interventions will not attract local ownership and results will not be sustainable after DFID support ends. Where DFID's programmes are not maximising their opportunities to work with country institutions and other donors, there is a danger their uncoordinated support will add to the bureaucratic burden facing recipients and fail to contribute to significant efficiencies that can be achieved through coordinated and strategic responses to development challenges.

46. The Paris Declaration expires in 2010 and UK leadership will be vital in designing and achieving international consensus on a progressive, ambitious and inclusive successor. The UK government has been one of the foremost champions of the Paris Declaration and therefore has credibility and experience to take on a leading role in negotiating such an agreement.

Gideon Rabinowitz
Coordinator UK Aid Network
On behalf of the UK Aid Network's Steering Group – ActionAid UK, Action for Global Health, Bond, CAFOD, ONE, One World Action, Oxfam, Publish What You Fund, Save the Children, Tearfund, UNICEF, WaterAid, World Vision

4th July 2011

UNICEF—Written evidence

Recommendations:
• The UK Government should continue to increase its aid spending to meet the 0.7% of GNI target by 2013 and enshrine this commitment in legislation as soon as possible. The UK should use its influence to hold other Governments to account for their failure to meet their 0.7% commitments.
• All UK aid should be aimed at reducing poverty and focused on the most deprived and vulnerable. In the run up to the MDG deadline, the UK should prioritise meeting the MDGs with equity.
• The UK Government should reaffirm its commitment to, and expand its implementation of, the aid effectiveness agenda, and encourage other donors to do the same.
• The UK Government should prioritise children and young people in its planning, policy and practice and take a child rights-based approach to development programming.
• The UK Government should make equity a central goal for development policy, and adopt equity-focused approaches to the MDGs.
• The UK Government should find and support innovative financing mechanisms to provide the new and additional funding needed to meet its long term climate finance commitments.

1. Introduction

1.1 UNICEF, the United Nations Children's Fund, is mandated by the UN General Assembly to advocate for the protection of children's rights, to help meet their basic needs and to expand their opportunities to reach their full potential. UNICEF is guided by the UN Convention on the Rights of the Child (CRC) and strives to establish children's rights as enduring ethical principles and international standards of behaviour towards children.

1.2 The UK National Committee for UNICEF (UNICEF UK) welcomes the opportunity to submit to the Economic Affairs Committee's Inquiry on 'The Economic Impact and Effectiveness of Development Aid'. This submission will address the following questions:
- How useful is the UN target of rich countries giving 0.7% of GNI in ODA?
- How should ODA be allocated?
- In what ways, if any, can the British government improve the effectiveness of its development aid?

<u>2. How useful is the UN target of rich countries giving 0.7% of GNI in ODA?</u>

Recommendation:
The UK Government should continue to increase its aid spending to meet the 0.7% of GNI target by 2013 and enshrine this commitment in legislation as soon as possible. The UK should use its influence to hold other Governments to account for their failure to meet their 0.7% commitments.

Aid is critical for children's rights

2.1 Aid is a key part of the bigger picture of achieving child rights and equitable development. It can act as a global safety net and reduce historically rooted disadvantage in countries where the vast majority of the children grow up today. It has been estimated that if all developed countries set and followed a timetable to reach 0.7% of GNI by 2015, the world could make dramatic progress in the fight against poverty and start on a path to achieve the MDGs and end extreme poverty within a generation[480]. Failure to achieve the 0.7% target will result in failure to achieve the MDGs and universal realisation of children's rights.

2.2 Aid has already helped to protect and promote the rights of millions of children around the world, and the great strides made towards the MDGs would not have been attainable without it. For example:

- Aid has helped to ensure that around 4 million fewer children under-five will die this year compared to 1990.
- 84% of the world's primary-school-aged children now attend primary school.
- Improvements in key interventions— for example in HIV prevention and measles immunization —have reduced the number of child deaths from 12.5 million in 1990 to 8.8 million in 2008.[481]

2.3 However, despite these great achievements the need for aid remains great:

- On top of the millions already pushed into poverty in 2008-09, the World Bank estimated that an additional 64 million people could have fallen into extreme poverty in 2010 as a result of the combined lingering effects of the financial and economic crisis[482].
- Nearly half of governments in 126 low and middle-income countries sampled in a recent report are expected to reduce public spending in 2010-11 as a result of the financial crisis, with the fastest cuts occurring in those low income countries which most need to protect vulnerable populations.[483]
- Poor and vulnerable populations in many developing countries have been relentlessly coping with high food costs over the past few years. Domestic food prices remain on average 55% higher than pre 2007-08 levels. Strategies to deal with these problems, such as eating fewer meals, reducing expenditure on health, increasing debt and working longer hours in the informal sector have already been exhausted and further capacity for coping is severely limited[484].

2.4 As a result of the economic crisis, more and more donors are predicted to reduce their aid spending over the next few years[485]. This trend, alongside, the fact that many developing country governments look set to reduce their social spending, puts the achievement of the MDGs and the wellbeing of the poorest and most vulnerable children at risk. It more important than ever for donors to meet their aid commitments and the UK can and should continue to lead the way in doing so.

0.7% is a longstanding moral and political obligation

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480 The UN Millennium Project http://www.unmillenniumproject.org/press/07.htm
481 The UN Millennium Development Goals Report 2010 http://www.un.org/millenniumgoals/pdf/MDG%20Report%202010%20En%20r15%20-low%20res%2020100615%20-.pdf
482 "Global Monitoring Report 2010: The MDGs after the Crisis." World Bank, Washington, D.C.
483 Isabel Ortiz, Jingqing Chai, Matthew Cummins and Gabriel Vergara, 'Prioritising Expenditures for a Recovery for All: A Rapid Review of Public Expenditures in 126 Developing Countries' UNICEF
484 Isabel Ortiz, Jingqing Chai, Matthew Cummins 'Escalating Food Prices: The Threat to poor households and policies to safeguard a Recovery for All' UNICEF 2011
485 OECD 'Development aid reaches an historic high in 2010' 2011 **http://www.oecd.org/document/35/0,3746,en_2649_34447_47515235_1_1_1_1,00.html**

2.5 The 0.7% target for ODA is well-known in development discourse and has a long history. In 1968 an expert commission was established by the World Bank to "review the previous 20 years of development assistance, assess the results, and make recommendations for the future." In 1969, the Commission proposed the specific aid target: official aid amounting to 0.7% of GNP by 1975. In 1970, the UN General Assembly adopted a resolution calling for "economically advanced" countries to gradually increase their aid expenditure to reach 0.7% of GNP[486] by "the middle of the decade".[487]

2.6 Since then, commitments to the 0.7% target have been repeatedly reinforced at international, regional and national levels. In 2002, the declaration of the UN Financing for Development meeting in Monterrey called on developed countries to "make concrete efforts" towards the 0.7% target. At the 2002 European Council, EU Member States committed to reaching ODA levels of 0.36% of GNI by 2006 and in 2005 EU Member States were the first to pledge to meet the 0.7% ODA/GNI target by 2015, with a collective EU target milestone of 0.56% by 2010[488].

2.7 In addition, Article 4 of the CRC – the most widely ratified human rights treaty inexistence - states that "all States Parties shall undertake all appropriate legislative, administrative, and other measures for the implementation of the rights recognised in the present Convention… States Parties shall [also] undertake such measures … within the framework of international co-operation"[489]. Thus by ratifying the Convention (as the UK did in 1991) States Parties committed to take the best interests of the child into account in all actions and policies affecting children, and to protect and ensure children's rights around the world through UK international development policy. In its General Comment Number 5, the UN Committee on the Rights of the Child urged States Parties to meet their international development targets, including the UN target of 0.7% of Gross National Income (GNI) to be spent on Official Development Assistance (ODA), and advised that the CRC should form the framework for international development assistance related directly or indirectly to children, and that the development programmes of donor states should be rights-based[490].

2.8 The 0.7% target is thus a long standing political and moral international obligation for rich countries. However, while some countries have already reached 0.7% (e.g. Norway, Sweden, Luxembourg, Denmark and the Netherlands), others are still some way off (e.g. Italy, Portugal, Japan, Greece and the USA)[491]. Figures from the OECD show that the EU has fallen far short of its collective 0.56% goal for 2010, with a funding gap amounting to nearly 15bn Euros. Overall, EU aid represented 0.43% of GNI in 2010[492]. It is crucial that the UK meets its commitment to 0.7%, to demonstrate best practice, uphold its promises and cement its reputation as a world leader in international development.

3. How should ODA be allocated?

486 In1993 "gross national product" (GNP) was replaced with "gross national income" (GNI), an equivalent concept.
487 The History of the 0.7% target, OECD (Original text from DAC Journal 2002, Vol 3 No 4, pages III-9 –III-11 Revised June 2010) http://www.oecd.org/dataoecd/16/38/45539274.pdf
488 The History of the 0.7% target, OECD (Original text from DAC Journal 2002, Vol 3 No 4, pages III-9 –III-11 Revised June 2010) http://www.oecd.org/dataoecd/16/38/45539274.pdf
489 Article 4, The United Nations Convention on the Rights of the Child (1989) http://www2.ohchr.org/english/law/crc.htm
490 UN Committee on the Rights of the Child, General Comment No.5 para 61 http://daccess-dds-ny.un.org/doc/UNDOC/GEN/G03/455/14/PDF/G0345514.pdf?OpenElement
491 OECD press release April 2011: Development aid reaches an historic high in 2010 http://www.oecd.org/document/35/0,3746,en_21571361_44315115_47515235_1_1_1_1,00.html
492 Aid watch report 2011, Concord

Recommendation:
All UK aid should be aimed at reducing poverty and focused on the most deprived and vulnerable. In the run up to the MDG deadline, the UK should prioritise meeting the MDGs with equity.

ODA should remain focused on reducing poverty
3.1 The UK has been a progressive global leader in advancing the quantity and quality of aid and in contributing towards development goals such as the MDGs. The creation of DFID in 1997 with a remit to fight world poverty and the introduction of the 2002 International Development Act, which requires all ODA spent by DFID to be focused on poverty reduction, were key steps along this path.

3.2 However, there is increasing concern that its expanding budget could put pressure on DFID to absorb new responsibilities that are currently administered by other departments, such as the Foreign Commonwealth Office or Ministry of Defence, and that aid could be used for security or military-driven purposes and objectives, rather than for reducing poverty. This would seriously lessen its impact and have a negative effect on the rights of children across the world. Therefore, it is imperative that DFID maintains its commitment to counting UK ODA within the OECD DAC guidelines.[493]

3.4 The 2002 International Development Act provides an important safeguard for keeping aid focused on poverty reduction. However, it only applies to ODA channelled through DFID. Non-DFID ODA (around 10%) is not required by law to focus on poverty reduction, nor is humanitarian assistance (which includes funds channelled through the Conflict Prevention Pool). In fact, little of the ODA not channelled through DFID is actually spent on reducing poverty and a recent OECD peer review of UK aid said non-DFID aid was "more fragmented" and its "development impact" "less clear"[494]. To have maximum impact, all UK ODA should be allocated with a poverty reduction focus.

Achieve the MDGs with equity
3.5 At the 2000 Millennium Summit, world leaders adopted the UN Millennium Declaration and the MDGs - a set of time-bound and quantified targets for addressing extreme poverty. With less than four years remaining until the MDGs deadline and many of the Goals off-track, it is imperative that they remain a focus for UK aid.

3.6 However, the gains made towards the MDGs are largely based on improvements in national averages, and uneven progress has left millions of the world's most disadvantaged, vulnerable and marginalised children behind. Deprivations of children's rights are disproportionately concentrated among the poorest and most marginalised populations across countries, regions, and within countries themselves[495]. At a regional level, in child survival and most other measures of progress towards the MDGs, sub-Saharan Africa and South Asia have fallen far behind other developing regions and the industrialised countries. In 2008, half of the 8.8 million deaths of children under 5 years old took place in sub-Saharan Africa alone, and sub-Saharan Africa and South Asia together account for more than three quarters of the 100 million primary-school-aged children currently out of school. Sub-

[493] OECD DAC guidelines 'Is it ODA?' http://www.oecd.org/dataoecd/21/21/34086975.pdf
[494] OECD DAC, *UK Peer Review 2010: Main Findings and Recommendations*, 2010
[495] UNICEF, 'Progress for Children: Achieving the MDGs with Equity', 2010

Saharan Africa and South Asia also have the highest rates of child marriage, the lowest rates of birth registration and the most limited access to basic health care for children and to maternity services, especially for the poorest[496].

3.7 Within many countries, falling national averages of child mortality conceal widening inequities. For example:

- In 18 of the 26 countries where the national under-five mortality rate has declined by 10 per cent or more since 1990, the gap between the child mortality rates of the richest and poorest quintiles has either grown or remained unchanged. And in 10 of these 18 countries, this breach has risen by at least 10 per cent[497].
- The risk of stunting for children living in the poorest 20 per cent of households is twice as high as it is for those living in the richest 20 per cent[498].
- In the richest 20 per cent of households, 90 per cent of children attend primary school, compared to only 64 per cent in the poorest quintile[499].
- Women in the richest households are three times more likely to receive skilled professional care at birth delivery than women in the poorest households. They are also almost twice as likely to receive at least one antenatal care visit during pregnancy[500].

3.8 It is imperative that the UK leads the way in closing these gaps by prioritising the most deprived and adopting equity-focused approaches to the MDGs. It is not only morally right to focus efforts and resources on the most deprived and vulnerable children, evidence shows that it also is the most practical and cost effective way to achieve the health-related MDGs for children. UNICEF research shows that in low-income, high-mortality countries for every additional $1 million invested, an equity-focused approach to child mortality averts 60 per cent more deaths than the current path[501].

3.9 Targeting assistance at the most deprived and adopting equity-focused approaches is also strategically sound. Inequity is an issue which cuts across the development agenda and can constrain progress towards wider development goals. Across a large range of measures of wellbeing, there is a strong correlation showing that more equal countries do better[502]. Inequality results in health and social problems, generates political instability, and has a negative effect on growth, poverty reduction and social cohesion[503].

3.10 Several key international goals for children also require universality; such as MDG2: universal primary education, or the eradication of infectious diseases. Achieving these goals is not viable without targeting those who have been excluded. It is also illogical to leave the poorest and most marginalised until last, as we will find ourselves in 2015 facing the most difficult challenge of reaching the most deprived but with depleted resources and political will to do so. Equity-focused development, in line with a rights-based approach, not only addresses issues of access to services, but also the bottlenecks and barriers that prevent

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496 UNICEF 'Progress for Children: Achieving the MDGs with Equity' 2010
497 UNICEF, 'Narrowing the Gaps the Meet the Goals', 2010
498 UNICEF , 'Progress for Children: Achieving the MDGs with Equity' 2010
499 UNICEF , 'Progress for Children: Achieving the MDGs with Equity' 2010
500 UNICEF , 'Progress for Children: Achieving the MDGs with Equity'2010
501 UNICEF 'Narrowing the Gaps to Meet the Goals', 2010
502 For example, Wilkinson, R. and K. Pickett, 'The Spirit Level: Why More Equal Societies Almost Always Do Better' (2009) shows this for life expectancy, trust, crime, birth-weight, HIV and trust, among others
503 ODI, 2009, Equity in development: Why it is important and how to achieve it, ODI Working Papers 311 2009; UNICEF 'Global, Inequality Beyond the Bottom Billion', 2011 Working Paper

people from utilising services when they are available, which leads to more sustainable outcomes.

The principles of an equity-focused approach include:
3.11 *Understanding who, what and why:* In order to address inequity, it is crucial to understand the equity patterns within different countries. This requires identifying who are the most deprived, the nature of the deprivation(s), and the underlying causes using high quality data, disaggregated by a wide range of factors. These include: geography; race and ethnicity; minority status; disability; gender; and age. An equity-focused approach would analyse this data to identify the most deprived and target resources and assistance accordingly.

3.12 *Investing in what works:* Equity-focused approaches invest in proven, cost-effective interventions. For example, abolishing education fees, or introducing water points and separate toilets for girls and boys in schools boosts school enrolment. Packages that integrate primary health care, education and protection services also have the potential to reduce significantly child poverty and inequity among the most marginalized groups and communities.[504] Policies that aim to reduce inequities or target specific groups and reduce vulnerability, such as investing in girls' education, microcredit and social protection are also key aspects of equity-focused development.

3.12 *Overcoming bottlenecks and barriers*: Often even when services are available they are not used. This can be due factors such as social and cultural norms, the time and distance required to travel, a lack of information about, and/or uneven quality of services. Equity-focused development aims to overcome these obstacles to increase service access and utilisation. For example, essential services are more likely to be effective when integrated and embedded in the community and tailored to the specific needs and context of that community. Equitable development, therefore, aims to deliver essential services in the places where children actually live through methods such as investing in community health workers. Finance mechanisms, for example cash transfers and social insurance, can also help to overcome the financial barriers which can prevent service utilisation.[505]

4. In what ways, if any, can the British Government improve the effectiveness of its development aid?

Recommendations:
- The UK Government should reaffirm its commitment to, and expand its implementation of, the aid effectiveness agenda, and encourage other donors to do the same.
- DFID should prioritise children and young people in its planning, policy and practice and take a child rights-based approach to development programming.
- DFID should make equity a central goal for development policy, and adopt equity-focused approaches to the MDGs.
- The UK Government should find and support innovative financing mechanisms to provide the new and additional funding needed to meet its long term climate finance commitments.

Strengthen the mechanics of aid effectiveness
4.1 Aid is a vehicle through which donors provide resources to developing countries to achieve 'results' and development effectiveness. While focusing the delivery of aid in a way

[504] UNICEF Progress for Children: Achieving the MDGs with Equity, 2010
[505] UNICEF Narrowing the Gaps to Meet the Goals, 2010

which recognises equity is essential to enable effective development outcomes, it is also critical that donors ensure the processes through which they deliver aid are fit for purpose and enable aid to leverage development results.

4.2 International procedures or principles between donors and developing countries on how to ensure effective processes for aid delivery were first agreed in the 2005 Paris Declaration on Aid Effectiveness, with further additions made in the 2008 Accra Agenda for Action. The initial motivation for introducing these reforms was to "increase the impact aid has in reducing poverty, increasing growth, building capacity and accelerating achievement of the MDGs"[506]. By reducing administrative wastage, aligning with country demands and improving countries' ability to plan for the long term, the aid effectiveness process is a central building block in ensuring development results and outcomes.

4.3 Despite donors agreeing to enforce and implement these reforms, the final evaluation of the Paris Declaration[507] shows that it is far from being fully implemented, and many donors have not adopted the principles of the Declaration in any serious way. For example, many EU member states are off track to meet their aid effectiveness commitments and have been increasingly prioritising self-interested policies that are reflecting their own immediate security, migration and commercial interests[508]. Even the UK, which has been one of the more progressive donors in implementing aid effectiveness reforms, currently uses a minimalist implementation of the Paris agenda which overlooks key pledges on technical assistance and country systems[509]. Of all bilateral aid in 2008 less than half was available to developing country partners to allocate according to their identified priorities, and even though overall aid flows have increased, less than half of new aid since 2000 has been spent on the MDGs.[510]

4.4 In this context, the upcoming 4th High Level Forum on Aid Effectiveness (HLF 4) in Busan, South Korea in December 2011 is an important moment for donors to reaffirm their commitments to aid effectiveness, and take further steps towards improving aid processes. Without doing so, it will be more difficult to achieve effective development and lasting results. Achieving the best possible development results requires the maximum possible resources to be available at country level. The global aid effectiveness process between donors and country governments is an essential component of achieving this, and preventing aid being wasted before it can create positive outcomes for children.

4.5 The UK has an influential role among donors, and should use this to hold other donors, especially EU member states, to account for their aid effectiveness commitments, and encourage them to reaffirm and strengthen their commitment to reform at HLF4. It is also important that the UK reaches out to engage emerging donors, the private sector, and philanthropies, which are increasingly larger players.

Prioritise children and young people

506 Paris Declaration on Aid Effectiveness 2005
507 Final Evaluation (Phase 2) of the Paris Declaration, 2011 http://www.oecd.org/document/60/0,3746,en_21571361_34047972_38242748_1_1_1_1,00.html
508 Aid watch 2011, Concord p.5
509 Reality of Aid 2010, "Political Overview: Towards Development Effectiveness" in Reality of Aid 2010 Report
510 Reality of Aid 2010, "Political Overview: Towards Development Effectiveness" in Reality of Aid 2010 Report

4.6 In the world's 49 least developed countries almost half the population is under 18[511]. Thus achieving real results and sustainable progress towards the MDGs will be difficult without prioritising children and young people. Today's children and young people face a number of challenges which will increase their vulnerability, and impact hardest on the most marginalised and poorest. These include an uncertain global economic outlook; high levels of youth unemployment; an escalating number of humanitarian crises and conflicts; climate change and environmental degradation; and rapid urbanisation[512]. Yet despite the fact that they will inherit the legacy of the policies that we enact today, and will bear the brunt of many of the most threatening issues of our time – all too often children and young people are ignored by donors and policy-makers[513]. For example, the UK Government has produced a strategy on maternal and newborn health (covering babies up to 28 days old) but no comprehensive strategy exists for ensuring the health of children or young people. Yet failure to address the challenges faced by children and young people will undermine any progress made in newborn health[514].

4.7 Investing in children and young people increases their chances of survival and of a productive future.[515] It is not only the right thing to do; it is also the most pragmatic course of action, with long term economic and social benefits. An individual's health and well-being is cemented in early childhood, so it is the best time to break the cycle of poverty, or ideally to prevent it from even starting. Deprivations during childhood greatly hinder the abilities of children to achieve their full potential, thus perpetuating cycles of poverty and hunger, and hampering development and growth. Investing in children and young people, including through mechanisms such as child sensitive social protection mechanisms[516], could generate considerable long term cost savings for governments – not least by avoiding problems relating to poverty and ill health.

4.8 To achieve the best possible results, the UK Government should prioritise children and young people in development planning, policy and practice, and in line with equity adopt a Child Rights-Based Approach to development programming. This would analyse and address the structural causes of poverty and deprivation, resulting in long term and sustainable change.

Invest in equity

4.9 In difficult economic times, with new money scarce, it is even more imperative to channel development assistance and technical support to the most excluded and hardest to reach[517]. Focusing on those children who are the furthest away from having their rights fulfilled is where small interventions can make the biggest difference. Therefore to be most effective, ODA should be allocated with an equity focus (the principles of which are outlined in section 3: How should ODA be allocated?).

Money for climate change must be new and additional

511 UNICEF (2010) 'State of the World's Children Special Edition: Celebrating 20 Years of the Convention on the Rights of the Child', UNICEF, pp. 11, 31
512 UNICEF 'Narrowing the Gaps to Meet the Goals', 2010
513 Harper, Caroline. (2008) 'Why are children's rights invisible?' ODI Opinion December 2008; ODI (2009) 'Children in times of economic crisis: past lessons, future policies', ODI Background Note March 2009; UNICEF State of the World's Children, 2011
514 UNICEF, State of the World's Children, 2011
515 UNICEF 'The importance of investing in children', 2011 http://www.unicef.org/socialpolicy/index_53294.html
516 Isabel Ortiz, Gaspar Fajth, Jennifer Yablonski and Amjad Rabi 'Social Protection: Accelerating the MDGs with Equity' UNICEF 2010
517 UNICEF Narrowing the Gaps to Meet the Goals, 2010

4.10 The UK's commitments to international climate finance must be considered in the context of the effectiveness of the UK's ODA. In 2009 at COP 15 in Copenhagen, developed countries (including the UK) committed to contribute 'new and additional' finance of $100 billion per year by 2020, to be equally split between adaptation and mitigation. The scale of the challenge presented by climate change should not be underestimated. The amount needed for climate finance is roughly equivalent to the total current global flows of ODA. It is not as simple as just 'slotting in' climate finance obligations into existing ODA budgets.

4.11 To ensure that ODA isn't directed away from existing development goals as the climate need becomes more urgent, it is vital that the UK contributes its fair share in additional climate finance. The unaddressed impacts of climate change could undo the progress already made towards the MDGs – a point reaffirmed at the 2010 MDG Review Summit.[518] There needs to be a guarantee of sufficient existing funds to meet the MDGs and new and additional funds for climate mitigation and adaptation in order to respond to climate change. Long-term climate finance (additional to ODA) is essential to protect those who are most vulnerable to climate change and ensure the maximum effectiveness of UK aid.

June 2011

518 UN Millennium Development Goals Review Summit Outcome Document, September 2010 http://www.un.org/en/mdg/summit2010/pdf/mdg%20outcome%20document.pdf

WaterAid—Written evidence

WaterAid is an international NGO working in 26 countries in Africa, Asia and the Pacific region to improve communities' quality of life through lasting improvements to water, sanitation and hygiene education using local skills and practical, sustainable technologies. We believe that these basic services underpin health, education and livelihoods, forming the first essential step in overcoming poverty. We strongly believe that well-targeted official development assistance (ODA) has an important role in supporting development and economic growth in developing countries. This note focuses on the economic benefits of ODA to the water, sanitation and hygiene sector.

There is a global water and sanitation crisis and this is negatively impacting on the economic growth of developing countries. 2.6 billion people are currently living without adequate sanitation and 884 million people don't have access to safe water. The overall economic loss in sub-Saharan Africa due to lack of access to safe water and basic sanitation is estimated at $28.4 billion a year, or around 5% of sub-Saharan Africa's GDP.[519] A recent study by the Water and Sanitation Programme of the World Bank (WSP) assessed the annual economic impact of poor sanitation in a range of countries in Asia, and concluded that the costs were equivalent to:

- US$53.8 billion in India, around 6.4% of GDP
- US$6.3 billion in Indonesia, around 2.3% of GDP
- US$193 million in Lao PDR, around 5.6% of GDP
- US$1.4 billion in the Philippines, about 1.5% of GDP

The following examples are taken from WaterAid's submission to DFID's Bilateral Aid Review. They all have a direct or indirect impact on a country's development and economy.[520]

Health, education and economic benefits of investing in water and sanitation

On the rare occasions poor people are asked to articulate their own preferences, water comes out highest.[521] Water, sanitation and hygiene (WASH) poverty exacts cumulative costs on the life chances of the poor and on national development.

The economic returns from WASH are strong and pro-poor (MDG1); for every £1 invested in WASH, the World Health Organisation (WHO) estimates an economic return of £8, mainly through time savings and reducing productive days lost to illness.[522] The benefits are pro-poor because the losses from lack of access are borne disproportionately by poor people.

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519 World Health Organisation 2006

520 http://www.wateraid.org/documents/bar_submission_oct_2010_fin.pdf

521 In the first generation of PRSPs that held significantly robust national surveys (Cameroon, Zambia and Uganda) water came out as the highest preference of poor people. Malawi was an exception where it came third. Nigeria's new government in 2007 conducted a national survey where water came first. The Pew Global Attitudes Survey 2007 did not directly ask water as an option. But when asked to rank the importance of particular services, water ranked above health and education.

522 WHO (2007) Economic and health effects of increasing coverage of low cost water and sanitation interventions.

Additionally, more girls stay in school after WASH investments (MDG2). Girls miss school because they must spend hours fetching water for their families. With the onset of puberty, unisex toilets and the lack of menstrual hygiene facilities deter attendance. A WaterAid study from Tanzania found a 12% increase in girls' enrolment when clean water points were installed closer to home.[523] In 2000 a UNICEF school sanitation programme in Bangladesh was instrumental in increasing the number of girls enrolling by 11%.[524]

The burden of WASH poverty falls disproportionately on women (MDG3) 72% of the population tasked with water-fetching labour are women and girls.[525] In much of rural Africa and South Asia, women and girls spend on average two hours a day collecting water, often from dirty, unprotected sources.[526]

A recent study of the causes of child mortality published in the Lancet found that diarrhoea was the biggest killer of children in Africa, killing more children than malaria, measles and AIDS combined. 90% of diarrhoeal deaths are caused by inadequate sanitation, unsafe water and poor hygiene (MDG4).

Furthermore, basic water and sanitation services are a key element of resilience to climate change. The precise impacts of climate change on WASH are hard to predict, but much of adaptation is about water – too much, too little or the wrong type. The poorest people are most at risk because they are already the least able to cope with seasonal change and extreme weather. WASH access improves their resilience and their ability to adapt to climate change.

Investment in water and sanitation delivers the following key benefits:

Greater productivity
Investing in sanitation and water frees up time and increases productivity. In many poor societies, women and girls are expected to be responsible for collecting water; a time-consuming and unpaid daily burden which leaves them with less time for education and paid employment. Meeting the MDG target to halve, by 2015, the proportion of people without sustainable access to safe drinking water and sanitation would free up 20 billion working days each year, which could be used for generating additional income.[527]

Health benefits
The cost of treating diarrhoeal disease drains both national budgets and family finances. If everyone had access to adequate sanitation and water services, the world's health sectors would save around US$12 billion every year, and patients themselves would save US$565 million.[528]

Impact on business
As well as the direct household effects, poor sanitation and water can have larger scale effects. First, it can impact negatively on tourism, reducing the number of **foreign tourists**. Second, it can affect the efficiency and effectiveness of the business sector, including having

523 WaterAid (2000) Looking back: the long-term impacts of water and sanitation projects.
524 UNICEF (1999) Sanitation and Hygiene: A Right for Every Child, New York.
525 WHO/UNICEF Joint Monitoring Programme 2010.
526 UNDP (2006) Human Development Report 2006.
527 (Hutton/Haller/Bartram (2006).
528 (Hutton, Haller (2004).

an influential role in where **foreign businesses** invest their money. Emerging evidence from Asia suggests that a country's reputation of having a poor environment, polluted water and an unhealthy workforce can affect the earning power of foreign currencies, and hence hinder economic growth. Furthermore, as the effects of climate change are felt, with increased predictions of extremes such as flooding and droughts, it will become even more important to invest in resilient water and sanitation supply systems to ensure the availability and safety of the water supply, as well appropriate sanitation options that do not further stress water supplies nor pollute dwindling water resources.

Other benefits of improved water and sanitation rarely captured in economic studies are 'intangible' or difficult to measure impacts. These aspects can include dignity, comfort, privacy, security, and social acceptance. An undeniable basic need is to have a nearby, safe and private place to defecate, and this is especially true for women, elderly people, sick people, and also children. As well as facilities at home, water and sanitation at schools can improve school enrolment, attendance and completion, and at the workplace can increase female participation in the urban workforce. Hence investment in water and sanitation promotes social equality and economic growth.

ODA can support domestic resources to deliver effective water and sanitation investment

There are many examples of where well-targeted aid has supported developing country governments and delivered effective outcomes. In **Uganda,** which has been a significant recipient of UK and other donor country ODA over the last decade, major progress was made in bringing water and sanitation to the country's population. Top-level prioritisation of the sector was seen as a means to address poverty, as President Museveni and his advisors pushed to integrate poverty reduction initiatives into government planning and budgeting processes more effectively. The Ministry of Finance, Planning and Economic Development supported the reform process with greater allocation of resources. The Ministry of Water and the Environment produced sector reform proposals in partnership with donors, who were willing to take the step of channelling funds through the Ugandan Government budget. Decentralisation and extensive training and capacity building at district levels helped local officials carry out the policies. As a result, millions of Ugandans living in rural and remote areas now have improved access to clean water, with major benefits accruing in health and economic outcomes.[529]

In **Laos** the National Centre for Environmental Health and Water Supply (Nam Saat) in the Ministry of Health was created with the support of the international development agency UNICEF. Nam Saat is the lead sector agency responsible for the rural water supply and sanitation sector in Laos and a key driver of progress in the country's rural sanitation. Prior to its establishment, there was no institution for rural water supply and sanitation. The support from UNICEF in institution-building led to an increase of rural sanitation access from 10% to 38% from 1995-2008, delivering major health, development and economic benefits.[530] **Vietnam** has received significant amounts of ODA over the past decade, and with this support succeeded in increasing access to sanitation from 57% to 75% and access to water from 79% to 94%.[531]

[529] ODI, Mapping progress: evidence for a new development outlook, 2011
[530] Ibid
[531] UNICEF/WHO Joint Monitoring Programme, 2010

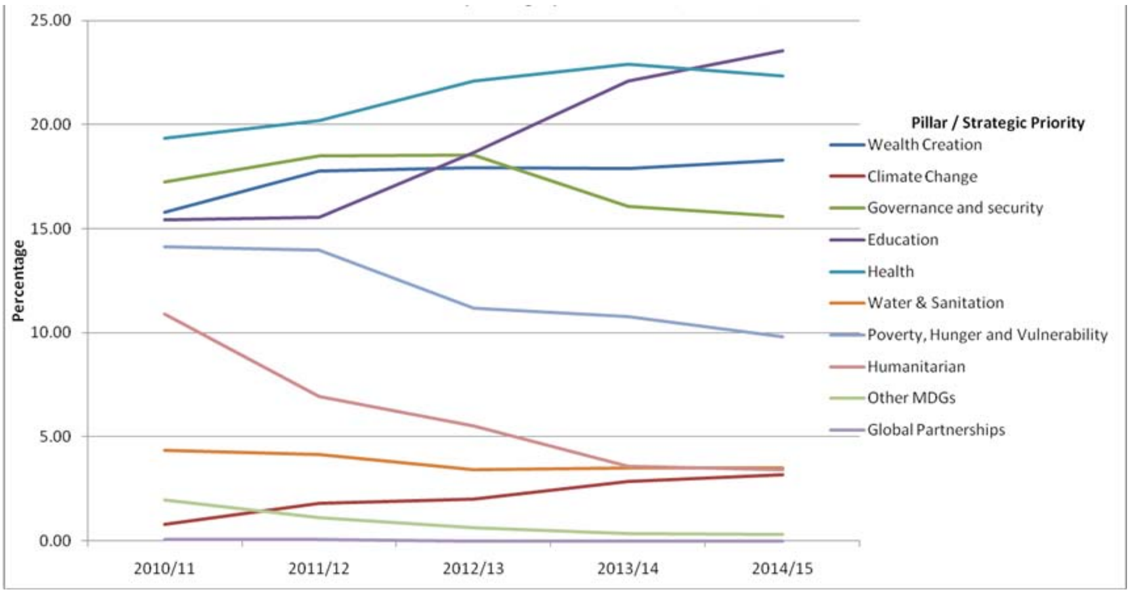
Some donors are showing a welcome focus on results. The Japan International Cooperation Agency (JICA) reports that between 2004 and 2008 Japan's ODA brought safe water to 28 million people in 48 countries. The International Development Association of the World Bank is aiming to deliver clean water to 36 million people over the next few years. The UK reported that in 2009-10, DFID bilateral programmes provided safe water to around 2.8 million people in Africa and around 2.3 million in Asia. A further 1.8 million people in Africa and 14.5 million in South Asia have also benefited from access to improved sanitation.

These are clear examples of how ODA is effectively and successfully supporting health and economic outcomes.

How the UK can improve the effectiveness of its ODA

Increasing DFID's ambition on water and sanitation
Despite the UK Government's stated commitment to prioritise ODA on basic services such as water and sanitation[532], analysis of DFID country operational plans suggests that the water and sanitation sector is a relatively low priority.[533]

DFID Bilateral Spending by Sector, 2010/11 – 2014/14



In the Bilateral Aid Review, the Department stated its aims to support access to clean water for 15 million, 25 million for sanitation, and 15 million for hygiene. The focus on results, while welcome, reveals that DFID's ambition for the sector is modest. WaterAid is seeking to bring access to water or sanitation for 25 million by 2015, and we would have expected a major donor such as DFID to set its ambition commensurate to the scale of the problem: almost 900 million without access to clean water and over 2.5 billion without access to sanitation.

Despite overall increases in aid, DFID's WASH spending is stagnating. The UK's portfolio should be rebalanced by skewing aid increases in favour of WASH. Without this, UK

532 The Coalition: Our Programme for Government, May 2010
533 Analysis conducted by the UK Aid Network, May 2011

taxpayers' investments in other human development sectors will gain only marginal rates of return.

DFID should raise its ambition commensurate with the task of achieving the water and sanitation MDGs. It has the capability, with an increasing aid budget, to lift an estimated 100 million people out of WASH poverty at a cost of £600m per annum. With economic returns of £8 for every £1 invested, this represents good value for money, in line with the Coalition Government's pursuit of development outcomes.

Include WASH in health and education strategies
DFID will improve the value for money it achieves by integrating its water and sanitation strategy with its health and education strategies. For example, DFID should take a comprehensive approach to reproductive, maternal and newborn health that addresses the significant burden attributable to poor water, sanitation and hygiene. Cross-sectoral results (for example, under-five mortality and under-five nutritional status) should be the principal points of accountability for UK aid investments and the assessment of DFID's programme effectiveness. DFID should build on the models of sector integration in its programmes so that, for instance in Tanzania, no new schools are built without adequate hygiene and sanitation facilities.

Coordinate effectively with other donors
As the 2011 Busan High Level Forum on aid effectiveness approaches, the UK and other donors must coordinate better among themselves and work with non-traditional donors, in order to ensure that resources are allocated efficiently and predictably to enable recipient governments to plan investments more effectively. DFID and the bilateral donors active in the sector need to work together to harmonise criteria for targeting WASH aid according to need.

In countries where the sector is weak, rather than bypassing government systems, donors need to provide targeted support to government in order to establish and strengthen sector planning processes and build capacity to absorb and spend scaled up investment effectively. The post-2015 international aid architecture needs to reverse the current neglect of sanitation by developing a more rational approach to aid allocation on the basis of need and adopting an integrated approach to investment in basic social services.

Lead the recovery of WASH in international development
Turning around the priority given to the water and sanitation sector requires an international global partnership. The Sanitation and Water for All initiative has made a promising start: since its inception it has leveraged additional commitments of nearly US$1 billion from the domestic resources of 18 Low-Income Country governments. So far, it is the nearest the aid community has come to developing a mechanism that delivers the promise that no credible national plan should be allowed to fail for lack of finance. This is a real opportunity for the UK to continue to demonstrate leadership on aid effectiveness.

June 2011

Professor Aiden Wood and Mr Roger Riddell—Oral evidence (QQ 1-30)

Please see under Mr Roger Riddell

World Vision—Written evidence

World Vision is a child focused Christian relief, development and advocacy organisation dedicated to working with children, their families and communities to overcome poverty and injustice. We are the world's biggest local charity, working in nearly 100 countries to improve the lives of about 100 million people worldwide.

We are pleased to make this submission to the Committee in which we have focused on areas directly relevant to our work and the experiences of children in fragile states and living in poverty.

Question 6: How should ODA be allocated? How far do (and should) the Millennium Development Goals (MDGs) shape aid allocations?

1. **The MDGs present the best opportunity that the world has to impact upon poverty**. While discussions about what comes after the MDGs have their place, World Vision is concerned that this may distract attention from achieving the current goals, and urges governments to redouble their efforts to meet them by 2015.

2. The **value of the MDGs has been to provide clear, common and measurable targets** around which all development actors can cooperate. They also act as effective signals for ensuring that aid is allocated to sectors in which progress is slow. World Vision UK has been campaigning for the UK and other Governments to put particular emphasis on and resources into MDGs 4 and 5 (on child and maternal health) which remain the most off-track.

3. However **the MDGs are equity neutral.** This means that the most logical way of meeting the goals is targeting groups in easy to reach populations for whom a small intervention can result in the target being reached. There is no incentive for donors to invest in the most vulnerable and harder to reach, for whom large investments are necessary but which will not result in any major contribution to the MDGs being met. World Vision focuses on the poorest in the hardest contexts, especially children. These communities are often the most neglected and the MDGs fail to incentivise donors to do otherwise. As such **the MDGs are an effective early warning system and a guide for allocating ODA, but Governments must consider the targets on a country by country basis and consider how money can be allocated to where the need is greatest, not just on the easiest to reach targets in order to realise the MDGs.**

Question 7: How useful is the UN target of rich countries giving 0.7% of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?

4. Spending 0.7% of UK's GNI on aid would deliver one of the UK's longest standing international commitments and improve the lives of millions of people living in poverty. **World Vision strongly backs the Government's commitment to legislating on this** and urges them to do so during the life of this Parliament.

5. **Aid, if used well, can ensure longer-term economic development**. An increase in aid to sectors such as health is one of the soundest investments the international community can make in future economic and social development[534]. However currently **there is a significant funding gap in sectors such as child health**[535]. **The commitment to a 0.7% target is an essential step towards ensuring sufficient and predictable financing**. The 0.7% commitment is **important in increasing peer pressure on those governments which are not taking up their share of the responsibility.**

6. **As well as increased levels of ODA there must be increased accountability** for the use of these increased resources by both donor and recipient countries[536], using mechanisms such as the Commission on Information and Accountability for Women's and Children's Health as part of the Global Strategy for Women's and Children's Health. Such transparency will highlight where capacity needs to be strengthened to ensure that aid is effectively used.

7. Meeting the 0.7% target is a first step to empowering communities to move out of poverty. To ensure aid is used effectively, there must be **strong developing country ownership** (with effective national plans in place) **backed up by donor funding that is predictable, coordinated and fully aligned with national priorities and systems**.

8. **Reaching the 0.7% target would not overwhelm countries in receipt of that ODA** and our experience of working in nearly 100 countries is that there is a near universal call for countries to meet this target. However, countries should scale up and not backload aid. Year on year increases until the target is met would enable countries to build the capacity to use the aid effectively. While we welcome the Government's commitment to aid, we believe it would have been more effective and would have provided better value for money to have increased each year until 2013.

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534 World Vision (2009) Child Health Now: Together We can End Preventable Deaths, p. 70 (available at https://childhealthnow.com/docs/en/child-health-now-report.pdf)

535 World Vision's calculation is that the annual external financing requirement would be $37.5 billion by 2012 and $42.5 billion by 2015 (ibid. p. 50). WHO's 2010 Global Strategy for Women's and Children's health also notes that 'in many countries, there remains a large funding gap that must be filled in order to reach women and children with basic health services'. (http://www.who.int/pmnch/topics/maternal/201009_globalstrategy_wch/en/index5.html)

536 See the World Vision commissioned piece: Leni Wild and Pilar Domingo (2010) Aid and accountability in health: key themes and recommendations, ODI Policy Briefing 42

Question 9: How does and how should development assistance engage with security concerns, at a global level and at the level of individual (fragile) states?

9. World Vision UK recognises that **development assistance does not occur in isolation from the UK's diplomatic and defence agendas**, and that there is a need for 'policy coherence' in ensuring that the different arms of the UK government are working with rather than against each other in promoting development[537]. However it is important to understand that within that broader overarching goal of promoting British interests, **each of these arms of government have a distinct purpose and confusing these can undermine their ability to fulfil that purpose.**

10. **The purpose of aid is, and must remain, poverty reduction.** Where this aim overlaps with UK trade, security or other interests then this enables the Government to more easily make the case for aid. World Vision appreciates that in making the case for aid, the UK Government will often cite these factors. However, **there is a danger that by focusing on the UK's interests alone, long-term sustainable investment and development gives way to short term trade or security concerns**. World Vision believes that the case for aid should be made without a focus on short term UK interests. The requirement that ODA be aimed at poverty reduction, as enshrined in the International Development Act, is an essential safeguard against this happening.

11. The **links between security and poverty reduction are well established and to achieve both purposes we must understand how the two interrelate**. Countries in conflict are much less likely to achieve any of the MDGs, and children are much more vulnerable. It is widely accepted that conflict is a major driver of poverty and it can therefore be appropriate for aid to be used to prevent conflict[538].

12. As such World Vision UK consider it **legitimate, and appropriate, for ODA to be directed towards countries affected by conflict** and to direct aid towards programmes and interventions with the explicit aim of preventing conflict from arising, or helping to reduce or resolve conflicts.

13. **British diplomacy, defence and development assistance may each be pursuing complementary goals in reducing conflict but for different reasons.**

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537 Matthew Lockwood and Sarah Mulley, with Emily Jones, Alex Glennie, Katie Paintin and Andrew Pendleton (2010) Policy Coherence and the Future of the UK's International Development Agenda: A report to World Vision UK by the Institute for Public Policy Research

538 The World Bank's 2011 World Development Report notes that no low-income fragile or conflict-affect country has yet achieved a single MDG and poverty rates are, on average, more than 20 percentage points higher in countries where violence is protracted than in other countries. (World Bank (2011) World Development Report 2011: Conflict, Security and Development (http://wdr2011.worldbank.org/)

Counter-radicalisation, for example, can be a by-product of DFID programmes, but not the ultimate driver. It can contribute insofar as poverty is a cause of radicalisation, with more security focused programmes addressing other drivers, given that the drivers of extremism are highly complex and radicalisation can occur in developed societies too.

14. World Vision UK welcome's **DFID's inclusion on the National Security Council (NSC).** The work of the NSC and the decisions it makes have an impact on people living in fragile states. It is right that there is greater policy coherence; however, DFID's mandate in the NSC is to promote the poverty reduction goal of ODA. DFID's presence will also mean that consideration will be given to the humanitarian and development impact of national security decisions, and can argue for those decisions which cause least harm. **This Council should not be able to override ODA allocation decisions**. This should remain the remit of DFID alone, based on poverty reduction criteria. But they should also be informed and coordinated with the actions of other government departments.

15. The implications of this perspective of ODA's role being distinct, but complementary to the work of other government departments:

    a. **Avoid the militarisation of aid** and the use of the military in the delivery of aid as this can undermine the legitimacy and effectiveness of development assistance. World Vision recognises that often aid and military actors may share the same 'space' and as such NGOs such as World Vision must engage in 'principled pragmatism' – being practical but always seeking to maintain the distinct purposes of their activities[539]. Likewise, governments must ensure they don't blur the lines between aid and politics in a way that compromises the neutrality of NGOs.

    b. **Prioritise system strengthening** in fragile states, ensuring that legitimate and competent states emerge that are able to provide basic services for their citizens and so rebuild a social contract between state and citizen that promotes stability and prosperity. In some cases, when the state is unable or unwilling to provide basic services, there may be a need for more direct donor interventions, but this should always be balanced up by working to strengthen national institutions.

    c. **Invest in fragile contexts even if costs are high**: we accept that delivering aid in fragile contexts can be more costly than engaging in more stable states.

[539] See World Vision (2008) Principled Pragmatism: NGO Engagement With Armed Actors, available at http://www.worldvision.org.uk/upload/pdf/Principled_pragmatism.pdf. This is based on evidence from over 60 interviews held in different countries with an assortment of agencies.

While the costs may be higher, the benefits can be proportionately even greater. As well as securing immediate benefits for the targeted population, we contribute towards a positive cycle of increasing stability, security, prosperity and ultimately less aid dependence in the future. As such, while the Value for Money agenda is legitimate in a time of fiscal constraints in the UK, we must ensure that quick wins at low costs are not seen as of greater value than more long-term, and potentially risky, investments.

June 2011

Michela Wrong—Written evidence

I am a freelance writer who has covered the African continent for the last 17 years, working as a reporter for Reuters, the BBC and the Financial Times before becoming a full-time author of non-fiction books on the continent. My first book, "In the Footsteps of Mr Kurtz", traced the rise and fall of Congolese dictator Mobutu Sese Seko and won the PEN James Sterne Prize for non-fiction. My second book, "I didn't do it for you", was a portrait of the Red Sea state of Eritrea. My latest book, "It's Our Turn to Eat", tells the story of John Githongo, the Kenyan anti-corruption chief who turned whistleblower in 2005. All of my books, but particularly the latest, explore the relationship between foreign donors and African governments. Grand corruption and how to fight it has become a particular interest. In 2010 I won the James Cameron Prize for journalism 'combining moral vision and professional integrity'. I sit as a trustee on the boards of Human Rights Watch Africa, International Alert and Partnership for Transparency Fund, all non-governmental organizations active in Africa.

Below, I address the few specific questions to which I feel qualified to answer. But first I would like to make a few overall points, which concern the framing of the question the select committee has chosen to put.

Many of my remarks are critical of DFID, so I should first state that it has become clear to me, during the course of many conversations with analysts, academics, politicians and aid officials in Africa, that DFID is regarded as the most professional and effective Western development ministry active on the continent. Its behaviour is widely emulated and unashamedly mimicked by other, less effective Western agencies. For that very reason, however, it is incumbent on DFID to get a very tricky formula right.

The select committee's emphasis on the measurable *economic* impact of ODA risks sidelining many issues pertinent to deciding aid policy. Paul Collier estimates that in the last 30 years aid has added only one percentage point to annual growth rates of "bottom billion" economies, as he terms them. Better than nothing, but not enough even to compensate for their annual population growth rates. But aid's impact on developing countries is disproportionate – far larger – than its direct economic impact. In Africa this partly because of a culture of dependency rooted in the colonial experience and the superpowers interventions of the Cold War, scars which have yet to heal. Aid may actually constitute a very small part of an African government's budget. But its granting or withdrawal is seen by a recipient administration and its public as a hugely-important gesture of international support or disapproval. One spells hope and dynamism, the other despair and decline. Such perceptions feed into the business community's perception of risk and strongly influence investment decisions.

Secondly, ODA's *psychological, political* and *cultural* impact -- impossible to quantify -- clearly spills over into the economic arena. The West's aid to Mobutu Sese Seko during the Cold War convinced the population of Zaire that the regime could not be shifted and that internal dissent was therefore pointless. (In fact, Mobutu was very easily toppled by an invading rebel movement in 1997). I lived in Kinshasa from 1994-1995 and can attest to that widespread mood of passivity and resignation in a country whose elite were universally recognised to be ruthlessly looting its mineral resources. The long term economic impact of that despairing mind-frame has clearly been disastrous for both the citizens of the Democratic Republic of Congo and the rest of Africa. Recently, most African countries have embraced at least nominal forms of multiparty democracy. But ODA works to undermine that relationship of tentative accountability. In what can too often feel like a watered-down form of the colonial dispensation, recipient African governments become answerable to Western development ministries, rather than their own voters. ODA whittles away at the link between ruler and ruled, and I cannot overemphasise the extent to which many African citizens still feel the future is not theirs to mould or choose. If you believe that a vibrant democracy is a vital ingredient of longterm and, above all, *sustainable* prosperity – and I do - ODA's role in encouraging this sense of paralysis should be a source of concern.

Point 3 – What lessons, if any, can be learnt from the experience of former aid-receiving countries that have graduated from reliance on ODA?

Others will be able to provide you with cheering examples of such countries. The transition outlined is simply not taking place in the area I write most about: East and Central Africa and the Horn. What I see, instead, are governments who have depended on foreign aid to provide around 40 per cent of their operating budgets for several decades and show no apparent inclination to wean themselves off such dependency. Both Western donors and the African governments concerned appear to regard this as an open-ended and indefinite arrangement. I'm thinking of Uganda, Tanzania, Ethiopia, and Rwanda. Aid should aim for its own obsolescence – the principle of 'teach a man to fish' -- not its own perpetuation, but that ambition has been lost on some far horizon. As Stephen Ellis says in his new book "Season of Rains": "Development is like scaffolding that was originally put up around a house under construction. The scaffolding is still there and the builders still have not finished the house."

Point 5. Do conditions imposed by government donors on recipient countries improve the effectiveness of ODA? What has been the British government's experience?

The problem with ODA is not raising the necessary funds or identifying worthy recipients, it is the practical task of tamper-proof disbursement. It is massively difficult to disburse aid without falling prey to "leakage" – otherwise known as government corruption. ODA and corruption always go hand-in-hand, because aid is essentially seen by those entrusted with it as "free money", whose loss will go unnoticed by the giver and whose appropriation is nothing like as morally reprehensible as appropriating local tax revenue, for example. Donors waste time, staff and money setting irksome conditionalities, but if they don't, they risk seeing major corruption scandals explode on their watch. There is simply no way out of this conundrum. In an ideal world, ODA would all take the form of direct budgetary aid, empowering the administrations of developing countries to enact policies of their own choosing. In practice, that scenario has been demonstrated to be horribly naïve and irresponsible.

DFID, in my experience, routinely plays down the importance of this issue – the biggest existing challenge to ODA. This is in part because its increase in funding has not been matched by an increase in the staff numbers needed to effectively audit and police disbursement. The government of the day is more interested in assuring British taxpayers that it is getting closer to the 0.7 per cent aid target than going into the dull and unsavoury details of how that money is released and why tracking is necessary. The first part of the process woos potential voters, confirming the government's humane credentials, the second is only likely to impress aid industry wonks.

Kenya provides many examples of this problem. While researching my book on corruption from 2005-2009, I had several conversations with DFID staff in Nairobi. I challenged their continued funding of a government that had been revealed – thanks to whistleblower John Githongo, protagonist of my book – to have perpetrated a $1 billion dollar scandal called Anglo Leasing involving 18 inflated military and security contracts. I was told that, despite this alarming track record, DFID was completely satisfied with the Ministry of Education's handling of the funds being allocated to the free primary education programme and assured that "not a penny" of DFID money was unaccounted for. The primary education programme has been a flagship project for DFID in Kenya. A recent, long-overdue audit by the Kenyan Finance Ministry (cf attachment), triggered by an original World Bank audit, revealed that $47m was stolen by hundreds of officials at the Education Ministry during precisely this period. This discovery, a full *nine years* into the donor-funded programme, raises alarming questions about the level of checking and auditing performed by DFID officials who believe themselves – naively - to be fully on top of their dossiers.

Point 6. How should ODA be allocated? How far do (and should) the Millennium Development Goals (MDGS) shape aid allocations?

The NGO on whose board I sit, International Alert, has pointed out the weaknesses of the emphasis on MDGs in an excellent paper published last September. (http://drupal.alertinternational.co.uk/resources/publications/working-grain-change-grain) On the plus side, the MDGs served as a developmental baseline all governments could agree to. An unintended consequence, however, was to reduce progress on development to a robotic checklist of hospital beds, school desks and vaccination jabs. Ends have been confused with means. The removal of key political and governance factors from the equation has not been helpful. It fits rather too neatly into the tradition of IMF and World Bank delegations which arrive in an African capital to decide on whether or not to renew funding and carefully weigh up dry economic indicators while excluding as irrelevant glaring human rights abuses and gross corruption taking place before their eyes.

The other problem with MDGs is that the African countries I work in are going to miss most of them. As Gordon Brown told the Royal African Society at a June 28 breakfast: "The MDGS will not be reached in one century in Africa, let alone 2015." The MDGs therefore become not so much targets as statistical confirmations of abject failure, which helps no one. They could usefully dropped, in my view. In addition, I have yet to meet a member of the British public who knows what an "MDG" is, so they constitute an additional barrier to public understanding of the development debate.

Point 7. How useful is the UN target of rich countries giving 0.7 per cent of GNP in ODA? If the target was reached would it lead to more official development aid than developing countries could efficiently absorb?

African countries already face major problems absorbing the amount of aid theoretically available to them. The donor failure to coordinate various aid programmes is one of the main reasons for this, another is the fact that so many bright African graduates are first educated and then find jobs in the West, so skilled manpower is in short supply in the state sector. The 0.7 per cent target is surely innately problematical in that it places supply before demand – the wrong way to go about things. With an increasing number of governments rightly losing their previous status as "donor darlings" because of repressive policies, the question of who the West will be left to fund in Africa becomes pertinent here. The number of acceptable candidates is shrinking even as aid levels rise. The disparity risks encouraging DFID officials to turn a blind eye to flagrant abuse in the pressure to "get the money out of the door".

In the unlikely event that a future British government with a stomping majority decides it does not believe in the efficacy of ODA and wants to adopt a different approach to development (favouring the private sector, for example, or focussing on dismantling trade barriers), it should surely be free to experiment with that policy. Not so, if the 0.7 per cent target is enshrined in law. The target suits itself to the kind of highly effective but simplistic sloganeering of a Make Poverty History campaign. I see its value as a campaign slogan, but not as a permanent basis for policy, where it is more likely to become a straitjacket than a help.

Point 8. Does ODA complement or inhibit private investment in developing countries?

ODA undermines the private sector in one very simple way. In any society, the brightest and best educated members will go where the best salaries are to be found. If those are to be found at a DFID-funded NGO or government ministry, that's where they will go, instead of setting up their own business, for example. This phenomenon is at its most dramatic in post-conflict states. Virtually the only traffic on Rwanda's roads after the 1994 genocide were white SUVs, owned by international NGOs, many of them staffed by bright, motivated, returning members of the diaspora. The aid world effectively soaked up the talent desperately needed in rebuilding a traumatised state, distorting economic patterns accordingly.

Although DFID talks about wanting to liaise more closely with the private sector, I believe it goes against the philosophical grain of any government department of this nature to do so. The DFID officials I've met in the past tend to come from the civil service or the humanitarian world. They have not come from the private sector, they have little experience of the world of business, they do not understand how it operates or have any empathy with its players – in fact, one can detect a certain suspicion and hostility. I'd be very interested to know how many local businessmen are on nodding terms with DFID staff in Tanzania, Uganda, Ethiopia and Kenya. I doubt it is many.

This is a shame as in the time I have reported on Africa – 17 years which have witnessed enormous changes - I have registered that many of the most revolutionary agents for change have originated in the private sector, rather than ODA. Private radio stations. The mobile phone. Internet access. Telephone banking. Not one of these developments has received a penny of aid money, yet they have transformed Africa just as thoroughly as multiparty polls, the advent of constitutionality, free primary education, lower infant mortality and anti-retrovirals.

Point 10. How does and how should development assistance engage with security concerns at a global level and at the level of individual (fragile) states?

The Middle East and Maghreb is currently in the grip of the "Arab Spring", prompted by the exasperation of a generation of prospectless youngsters with a swathe of sclerotic leaders. Commentators have lambasted Western democracies for their past support of those authoritarian leaders, in the face of mounting evidence of corruption, electoral fraud and human rights abuses. My fear is that sub-Saharan Africa is going to experience its own version of the Arab Spring in 5-10 years' time and its targets will this time include Uganda'sYoweri Museveni (25 years at the helm), Ethiopia's Meles Zenawi (20 years) and Rwanda's Paul Kagame (17 years), with the West quite rightly vilified for its loyal support of those regimes. In many of these countries, British aid has been spent boosting police forces and providing non-lethal military equipment. These decisions may have been taken for valid reasons at the time, but the increasingly militaristic and repressive nature of these former "donor darlings" – both in terms of crushing dissent within their own borders and, in the case of Ethiopia, in "securing" neighbouring states - should give DFID serious pause for thought. In Uganda, the main opposition leader was tried for rape and, more recently, recently beaten by security forces and pepper-sprayed in the face. In Rwanda, an opposition leader was beheaded in the run-up to the last elections, a newspaper editor killed, and an exiled general narrowly survived an assassination attempt. Ethiopia's 2005 elections were rigged, thousands of demonstrators were rounded up, opposition leaders jailed and the government has recently moved to close down the NGO sector. It's striking how many of the countries which score badly on the index of press freedom published by Reporters Without Borders, an NGO, are on warm terms with our government. Rwanda is ranked 169 out of 178, Ethiopia scores only slightly better at 139. DFID support for these increasingly authoritarian regimes strikes me as a stance Britain will come to regret, undermining as it does the genuine desire to present our country as a force for progressive global change and casting Britain, in the eyes of a younger generation likely to seize power in Africa, firmly in the camp of morally-tainted "dictator's friend".

This is my overall concern. A more minor point is that military and security spending is always going to be a favourite area for "leakage" in a recipient government's range of activities. Military contracts are often not put out to open tender or subject to parliamentary scrutiny - as we saw in Kenya during the Anglo Leasing scandal – on the pretext of "national security". This makes security a prime area for top-level graft. Predatory officials can take their cuts on military spending, sure in the knowledge that ODA will provide the citizenry with many of the basic services – health, education, road-building etc etc – required to keep the population acquiescent.

I will close with one last point. It is extremely altruistic and intellectually high-minded of the Select Committee to devote its examination of ODA to its economic impact on recipients. However, any donor government must surely be accountable to two key audiences. The first is the poor of the developing world. The second – more important, surely, as its resources make ODA possible in the first place – is the British taxpayer. British taxpayers, in my experience, are largely unaware of the 0.7 per cent target or aid-related changes to the law, do not understand the difference between project and programme aid/humanitarian and development assistance and barely recognise DFID's existence as a government department with an impressive budget (the department's initials retain almost as low a visibility as when the department was first established). Yet opinion polls consistently show that they instinctively suspect that much of their aid money is feeding a culture of dependency and being stolen by corrupt officials abroad. Their instincts are sound. There is a tendency, in the world of aid, to embrace universal ideals and principles that arch above national concerns, soaring into an idealised moral stratosphere. But a government is answerable, first and foremost, to its funders. This applies just as much with aid policy as it does to military spending, health and education.

June 2011

Michela Wrong—Oral evidence (QQ 399-459)

Evidence Session No. 12. *Heard in Public.* *Questions 399 - 459*

TUESDAY 29 NOVEMBER 2011

Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Best
Lord Forsyth of Drumlean
Lord Hollick
Lord Lawson of Blaby
Lord Lipsey
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

Examination of Witness

Ms Michela Wrong, Author of *It's Our Turn to Eat*

Q399 The Chairman: Welcome to the Economic Affairs Committee. This is the 12th public hearing of our inquiry into the impact and effectiveness of development aid, and I have to say as a matter of form that copies are available of Members' entries in the Register of Interests. Welcome back to the Committee, Ms Wrong, and I would very much like to thank you for your written submission to us which was very eloquent, very well expressed and extremely interesting.

Michela Wrong: Thank you.

The Chairman: We are looking forward to questioning you on it. I would be grateful if you would speak out loud and clear for the webcast and the shorthand writer. Are you happy to go straight to questions?

Michela Wrong: Yes, sure, yes.

The Chairman: Let me begin with the first question, and it is really this. As I say, we have been very interested to read your evidence, and a powerful theme running through your three books on Africa, in particular the one on Kenya, is the corrosive effect of foreign aid on the development of local political systems. This is obviously something that we as a Committee have been very interested in. I wonder if you could describe briefly how in your experience this corrosion operates and what you see as the long term consequences for economic development.

Michela Wrong: Yes, thanks, and thank you for asking me here today. I thought I would just start off with two small anecdotes. One of them happened when I was working as a journalist in Kinshasa in Zaire, now the Democratic Republic of Congo, and it was when Mobutu was still in power and Parliament was endlessly being log-jammed and held up by Mobutu and trying to hold him to account. One of the parliamentarians came up to me and said, "Why don't you just get rid of him? Why don't the Americans come with a helicopter and take him away, you know, just like they did with Noriega?", and I looked at him and thought, "Those days have gone now and you have to get rid of him now. You are a Parliament", but it was also very understandable that he should say that, given Zaire's history of CIA and Western intervention.

But the other story that always has stuck in my head occurred when I was living in Nairobi as a journalist, in Kenya. There is this massive slum called Kibera, right in the city centre and on the outskirts of the presidential state house. As you go in, you see all these placards up, and these signs, who is digging which well, Danida, Save the Children, Marie Stopes, which clinic, which latrine. It is all being done by development agencies and NGOs, and there was this cholera outbreak and somebody was interviewing a local resident on the television, and he was looking at the television cameras and saying, "Where are the donors?", and I thought, "Why wasn't he saying, 'Where is the mayor? Where is the city council? Where are the MPs?', 'Where is the Government?'". He was saying, "No, where are the donors?". And for me it really exemplifies what seems to be a massive problem with aid, that you can talk the talk of democratisation and increasing accountability as a donor and how wonderful it is that multi-party democracy has been sweeping across Africa, but aid per se does whittle away the accountability of African Governments.

Jakkie Cilliers, who runs the Institute for Strategic Studies in South Africa, says accountability moved offshore with aid; it becomes a relationship between donors and African Governments, and you have this bizarre situation where African voters, queue up for hours and hours to vote—we have an election going on in Congo at the moment—yet in their heart of hearts they actually expect the donors to come in when there is a crisis, when something awful happens the donors are expected to be the ones that do something effective. I think you see this in all sorts of other examples, Governments, African Governments, often treat their own select committees with complete contempt. Their Public Accounts Committee reports, which are often extremely incisive, very revealing, are never acted upon. They also ignore what the local press says, which is often very brave, very outspoken, and are much more concerned about what foreign journalists like myself when I was working for the Financial Times used to say. If the IMF delegation was in town, if the World Bank was sending a delegation, that was very important.

What happened in parliamentary question time did not really matter and every year there would be this consultative general meeting with the World Bank and all the other donors, and the Kenyan Government. When I was living in Kenya, that was a really big deal, that was a very important event and you just began to feel what has happened to Parliament in all of this? What has happened to the relationship between the citizens and the voters, and the African Government?

So I hope that conveys what I mean about the corrosive effect. You can talk as much as you like about ownership but aid in its long-term impact is basically anti-democratic, and it seems to me it is essentially a neo-colonial relationship. If you have that relationship in a continent with a history of Western intervention, slavery, the Cold War, the Imperial scramble for Africa, then aid comes along and is just another one of these experiences in which your fate as an African citizen is decided by outsiders.

Q400 Lord Tugendhat: Could I just ask you a supplementary on this before I come to the main question? I am very struck by what you said. I always feel when I look at the television when there is a famine or some other natural disaster that the way in which it is reported, especially on the electronic media but in the press too, is always about what is the world community doing. You go to some dreadful place in Africa, the capital may very well be unaffected but the concentration is always on the locality where the problem is and the question is not what the Government is doing, why has this occurred in this country, what were the Government's policies; it is always what is the world community, whatever that may be, doing. I think that plays rather to what you have just said.

Michela Wrong: Yes, well, there is a reason for that because—the ads that you will see appealing for money and the fundraising appeals are all being designed and put out by Médecins Sans Frontières, Save the Children, people who want donations, so they are presenting it to the British public as their problem, their responsibility as decent human beings. But, yes, I think there is a real absence of content to the discussion.

Famines are not, on the whole, natural events. They are political events. They have been caused by the outcome of war, of food not being allowed to circulate around, of punishment being inflicted often deliberately by a government on a particular population, and all of these elements are routinely edited out by journalists either because they do not understand them, genuinely they are firemen who have been parachuted in without much context, or because often they are depending on the NGOs and the agencies for their safety, for their guards, for their transport, and for their perspective. You know, they will be briefed by the MSF or the DfID person or USAID or Save the Children. So they see it from that perspective.

Q401 The Chairman: Thank you, you have explained very clearly how things are as you have seen them on the ground. What conclusions do you draw from that or what recommendations would it lead you to make?

Michela Wrong: What recommendations would it lead me to make? I have a whole series of them. In terms of dealing with—you mentioned earlier that new Governments like the one in South Sudan, is that what you want me to tackle at this stage?

The Chairman: No, it is really from the aid point of view.

Michela Wrong: From the humanitarian aid or from development aid?

The Chairman: Development aid.

Michela Wrong: Development aid. Well, you know, I feel that we should be looking very closely at this drive for increasing aid to 0.7%. I am very concerned that that seems to be an ambition and target in itself, and I do not really understand where that comes from. It seems to be an artificial ambition. I think that there are all sorts of other factors to be explored in terms of involving the community more in aid choices that are made.

There is a tendency to talk directly to Governments, to exclude civil society. When you have these consultative general meetings with the World Bank and the donors in African capitals, civil society is usually invited along as a politeness but they do not really have much say at those meetings. It is the sort of conversations from which they are excluded and it is also a fact that most of the local press in places like Nairobi or Kinshasa do not understand aid and they do not understand what the IMF is doing, what it is looking for, what its criteria are. So there is a comprehension gap as well with the local media and the coverage of it.

Q402 Lord Lawson of Blaby: Which element of civil society do you think could give the most useful input if they were seriously consulted?

Michela Wrong: I think what I would like to see, because it has been my particular focus—but I realise it is not the only focus that there is—is some of the anti-corruption groups being more included in the debate. Transparency International for example, who I think you are going to be hearing from, they have a branch in every African country I have ever been to. That would be nice to see them playing a role.

The church is incredibly important in many of the African countries I have worked in and they certainly do more in terms of grass roots action and work with the community than any other organisation, the mosques likewise. Yes, and then there are human rights organisations as well. In places like Kenya where you have had an awful recent history of civil strife and really nasty ethnic violence taking place, I think you have to be as inclusive as possible in future. So it would be nice to see these players being included more.

Q403 Lord Hollick: Speaking of the media, you make the point that broadcast media, in particular firemen journalists, tend to cover the incident, the famine, the flood, whatever. Do the local media ever get to the sort of issues that you have raised? Do they talk about, “Well, why are the politicians not addressing this?”? Are they able to see the wood for the trees on some of these issues or are they prevented from so doing by the Government?

Michela Wrong: I think it really depends where you go. I have worked in African countries that had appalling press—mostly in Francophone Africa, interestingly. Anglophone Africa tends to have a lot of better, more impressive and challenging press. South Africa and Kenya both do, but I think it is more that they just do not really understand what an IMF programme is. They do not understand what the donors do and the conception locally is often out of sync with the reality in that there is an impression on the part of the media and the local population that the donors decide everything. In fact in somewhere like Kenya where there is quite a decent taxpaying base—the operating budget of the Government when I was there was only 4% supplied by donor aid. So it really is a rather small proportion but in the eyes of the local Kenyan population, it was enormously important. So they were always looking to the West for approval or disapproval. I think there is some massive misunderstanding of what donors do and the role they are playing, and business reporting is often the weakest part of the media in Africa, and you do have to have a basic grasp of how business operates to understand a World Bank programme or an IMF programme. That is not a strength that there is on the ground.

Q404 Lord Tugendhat: Zaire, or former Zaire rather, and present day Zimbabwe are both good examples of dysfunctional states that have had a lot of aid, but is the corrosion you describe an inevitable consequence of the aid relationship in any poor country?

Michela Wrong: I would say it is not inevitable but it is highly likely. By definition any aid programme is going to be in a state that needs help, and it needs help in many cases in Africa because you are dealing with countries that have come through a civil war, or some major civil strife where their institutions have been hollowed out or destroyed. The best civil servants and technicians have fled. The rule of law has collapsed and in many cases you will have a charismatic leader who has emerged, usually a warlord or the head of the army, and he has focused all power in his hands and he is also under threat from competing power blocs and players who would dearly like to get rid of him. He has to buy those people off.

All of those elements mean that it is a perfect recipe for corruption and I think my argument would be that if you are going into those areas, and you are going to be going into those areas if you are trying to help—and given DfID's new priorities they will be going into those areas more and more in the future—then you are going to get a problem with corruption. You have to take that from the outset as a very, very high likelihood, and my feeling is that is not really quite taken on board at the moment in DfID. I think that DfID can be on the back foot in terms of assessing the risk. It is not very good at assessing the risk. I believe that Margaret Hodges made the same remark recently.

The other thing that I would like to say is that I think it is a natural human reaction—certainly not special to Africa—to behave in a certain way if you are presented with something that seems like free money. Most African Governments, in the circumstances I have just described, have virtually no tax base. Taxes are really hard to raise and earn, so suddenly you are presented with money that is free, and any businessman who goes out and chooses the best restaurant in town because it is on expenses knows, when you have free money you tend to be a bit careless how you spend it.

So I think given those circumstances, that context, and given the fact that you are then given something that appears to not have an enormous value to the people giving it to you,—because otherwise why would they be giving it to you?—then yes, you are going to very likely have aid being swallowed up by corruption.

Q405 Lord Tugendhat: So what lessons would you take away from countries where, although there may well be a level of corruption, aid has served to strengthen civil society?

The countries I had in mind were Bangladesh, Botswana or Ghana, but if we look at Botswana as African, the southern part of the continent, and compare it with the experiences in Zimbabwe and Zaire, what takeaway would you have from that?

Michela Wrong: I do not know enough about Bangladesh but I would suspect it has more to do with what those societies were like before they went through their traumas. I think sometimes people make an analogy between the Marshall Plan and aid to Africa, and they say, "Look at the impact the Marshall Plan had".

Lord Tugendhat: I hear it is completely invalid.

Michela Wrong: Well, I was going to say it is invalid because you have societies where they had certain historic institutions, even if they had been razed to the ground, in many cases literally, and you had certain modes of behaviour. You had enormous level of education, technical skills, all of that ready to be rebuilt. Then you are operating in climates, in contrast, somewhere like Sierra Leone or Liberia where there is not any of that. I would suspect that a lot of the good examples—Vietnam versus Sierra Leone, for example— have much more to do with what that society was like before it went through its trauma. You recover and can build something much more easily when you have a solid foundation that people can still remember.

Lord Tugendhat: I quite agree.

Q406 Lord Lawson of Blaby: If I may follow up on that because I think that Lord Tugendhat's question is quite an important one. In confining ourselves to sub-Saharan Africa, which you know so well, there have been latterly, and maybe quite surprisingly because it is only latterly, one or two good news stories from sub-Saharan Africa. Botswana, as Lord Tugendhat mentioned, goes back quite a while; Ghana, it is a more recent good news story. To what extent do you attribute this to overseas development aid?

Michela Wrong: Well, very little, I would suspect. I think this is one of the problems, that we are in this area of imponderables. The problem with comparing Botswana to other countries is that it is such a tiny country and it does not have a history of ethnic division and tribal difference. Most of the places that I have worked in that have had problems of really deep-running ethnic competition that go back centuries. I have only been to Botswana once and my understanding is that that tradition is not there and it is a very small population. It is small physically. It also seems to be a lot easier to run a country well when it is fairly limited in size.

Ghana has had a really shocking level of corruption, it has to be said. The number of people in the Kufuor presidency, the number of people from the Kufuor family, who enjoyed government appointments is really quite shocking. I know people are very upbeat at the moment about prospects there, partly because of the oil discovery, and people are also hopeful that they will learn the lesson of Angola and Nigeria and not suffer from the resource curse. We have yet to see whether that is true or not.

Q407 Lord Smith of Clifton: Ms Wrong, Paul Collier's book, *The Bottom Billion*, does not overplay the potential contribution of aid but advocates an interventionist role for donors especially in fragile and post-conflict states. Your written evidence and books suggest Collier's analysis is too optimistic about the effects of aid, and you have already hinted at that to some extent in the last question. Is this a fair assessment, or what does he get wrong?

Michela Wrong: I would be very nervous about saying he gets major things wrong because he has a length of career and experience that I cannot hope to equal. He is a real economist and I am not. But when I read *The Bottom Billion*, for me what was really rewarding about it was its analysis of the structural causes of poverty. That was why I recommended it to all my friends because it suddenly helped me work out what were so clearly some of the key factors. Because you had mentioned the book in your questions I did go and look it up again, and Collier does strike a very nuanced position. He says that he thinks Jeffrey Sachs is massively over-optimistic when it comes to aid but Bill Easterly is too pessimistic. His conclusion seems to be that aid helps a bit but not very much. He does have a very interventionist line, it is true, but in fact his interventions are often not aid related. He talks about international charters; that is not dependent on aid. He talks about trade policy. I think everyone agrees "trade not aid" is something we all desire but do not quite know how to get to. As the years go by it remains a distant dream. Then he also talks about things like having western countries going to Governments and saying, "We will issue you with an anti-coup guarantee as long as your elections are clean and we will withdraw it if your elections are not clean". Once again, those are interventionist but they are not about aid. In a way, it strikes me that he is being very provocative. He obviously wants to make people think. He is very good at that. He is floating lots of ideas for discussion but he is also saying aid is not the only game in town.

Q408 Lord Best: Can I just follow that? Would those countries pay any attention to anything else that Paul Collier is requesting of them if there was not hard cash also involved? He thinks that aid can be effective in stabilising things in these post-conflict environments. He says that if a country was to fall apart—it is such a big thing to happen, if chaos follows the conflict; it is such a loss—that maybe aid for all its weaknesses is better than allowing terrorism and chaos to follow the conflict the country has suffered. That is what I took out of Paul Collier's book but you may not agree.

Michela Wrong: Can you narrow it down a bit?

Q409 Lord Best: Well, I think he is saying that he is obviously not a huge fan of aid as currently administered but that after there has been some horrendous conflict in a country then aid coming in, despite all the limitations on it, can stop the place falling apart completely. That is such a big prize, to not lose a country as we have done in one or two places, not least in Africa. To turn one's back on it and say, "These places are hopelessly corrupt. We are going to have to wash our hands"—

Michela Wrong: I am not here to make that argument. I am not Dambisa Moyo. I am not saying no aid. I think my career of three books basically constitutes me looking at an aid relationship between donors and countries that I have covered in some detail and getting alarmed and increasingly sceptical, as the years go by. But I am certainly not a radical jihadist in terms of no aid at all. I think particularly in the kind of scenario that you have just sketched, which is the Liberia scenario, the Sierra Leone scenario, maybe the South Sudan scenario of a young country that is really on its knees and trying to just put down the first structures of a working state, then I am sure you need technical expertise apart from anything else and, yes, you need money. But, of course, not all African countries are in those circumstances. Nigeria is not in those circumstances. Ghana is not in those circumstances—Kenya, Tanzania, Uganda, Ethiopia, a lot of these countries get a lot of aid from us. The trouble with Africa is it is 53 countries and they are all so different.

Q410 Lord Shipley: You said a moment ago that you are not against aid, but you are nevertheless pessimistic about the effect of aid as it is currently disbursed. I wondered what your view was about the implications for donors such as DfID as they try to work out how best to support reformers in weak states such as South Sudan.

Michela Wrong: Yes. I know that you are talking to the IACA people later on and I think they are really good people to talk to because they have also thought about this question. I was reading their report and I thought it was excellent. I think one of the points they make, and I would echo it, is to expect corruption. Do not wait for it, anticipate it and build in the safeguards from the start. Because especially in a young country, like South Sudan or Sierra Leone, it is going to be there.

As a journalist, I have ended up interviewing over the years many of these people who have run or worked for anti-corruption units, anti-corruption commissions that at a certain stage were the kind of flavour of the year with donors, who thought, "Set up an anti-corruption commission, it is like a silver bullet, it will take on corruption". They do not work. They get emasculated. They get co-opted. I think they probably still have to exist but they are not enough on their own. I have now interviewed so many. I have met the guy from Zambia who is out of work, the guy in Nigeria who fled and then stood for the presidency, the South African chap who is now at the UN. John Githongo fled into exile. He is now back in Kenya but not working for an anti-corruption unit. There are several more examples. There is one in Sierra Leone and he has left as well; two of them left in succession. Anti-corruption commissions are not the answer. I think, yes, by all means set them up but actually at the end of the day you have to shore up the police, the judicial process, make sure the judges exist, that the Attorney-General has independence of tenure and a decent salary so he is not open to corruption. There are many other things I would put the stress on. I think in those very weak states—and to be honest DfID already does this—you have to be more conditional. You often have to get involved and intervene in a way that is uncomfortable. Direct budgetary aid is often not recommended, is not a good idea, and I think DfID knows that.

Q411 Lord Shipley: Sorry, are you saying then that it is technical assistance that DfID and similar donors should limit themselves to pending improvements in governmental and judicial systems?

Michela Wrong: Well, the trouble is that you also have to get the oil of government machinery working, but I think technical assistance is definitely needed in those kinds of places. You have to be a lot less trusting and show a lot more oversight, and I think also work very closely with NGOs and communities on the ground, not sideline them, include them at that process, at that stage, because they have often played a very big role in drawing the country back from the brink of disaster.

One of the problems, as you see from the IACA report, is about a third, 34%, of money that goes through DfID goes through multilaterals. It goes through the World Bank and the IMF. They are much better now, but they have taken a while to wake up to the importance and damage done by corruption and they are extremely bureaucratic and slow moving. It is a little bit alarming if DfID is handing over a third of its aid to be disbursed through those organisations and it often does in these conflict-hit areas.

Q412 Lord Lipsey: Could I just ask what precisely you mean by technical assistance? Because we have had that used in two senses in this Committee; one is, as it were, engineers or people who know how to build roads or whatever, and the other is technical assistance in how you construct a government, so people who go out and say, "You organise the courts like this" or, "This is how you run an election". When you think of it as being possibly a more effective form of aid, which kind are you thinking of?

Michela Wrong: I was thinking more of the latter, although I am sure they could also do with the former. In Rwanda after the genocide, most of the magistrates, prosecutors and solicitors had all been killed, so then you had huge criticisms of the new Government set up by Paul Kagame because it had prisons that were chock-a-block. You used to go into the prisons and people would be pressed up against one another it was a human rights outrage, of course, the conditions they were being held in, but they could not be tried because the judges were dead. That was a very basic level of technical assistance that Rwanda needed and I think it got quite a lot of that help. But I am thinking more of the machinery of government. After the Moi era in Kenya the judges were mostly regarded—and the same thing had happened in Zaire—as having been politically bought off, the judicial process was completely discredited. Well, what about the Attorney-General who was also regarded as tainted? What about the head of prosecutions? All of these things are very important.

Q413 Lord Hollick: I took the inference from your written note that corruption is endemic within the aid programme. You say aid and corruption always go hand in hand. The British Government has put in place the ICAI, which you have just referred to. It is seeking to bear down through better accounting, better accountability, on corruption. What do you think are the prospects of it achieving that objective?

Michela Wrong: I think DfID deserves huge credit for setting up the IACA because it is a brave thing to do. I would like to think that nagging by people like me played a tiny role in that happening. I was very shocked by the recent Kenyan case. In Kenya there has been a primary education scandal exposed, which involved £33 million worth of money disappearing. Most of that is not British money. For years I was going to Nairobi, and I would interview DfID officials there and have off-the-record chats with them. I would say, "How can you be doing business with the Kenyan Government? We have seen Goldenberg, one massive scandal in the 1990s, the same political players surviving. Now we have had Anglo Leasing, the same political players keep surviving, and now you have this flagship aid programme,—primary education—and the Minister in question has been repeatedly named in connection with Goldenberg, Kenya's worst ever scandal. You are telling me that everything is fine and this is a good way of spending British taxpayers' money?" They said repeatedly to me, "We can account for every penny of British taxpayers' money. Not a penny is going missing". That programme went on for six years before anybody noticed anything. I think it is absolutely shameful.

Now, that was under new Labour but I think it shows you that what DfID has in the past regarded as close policing and what the rest of us regard as careful policing are not one and the same. Now we have the IACA. I think the report is great, but it highlights things that have to be addressed and I am not clear how they are going to be addressed. It talks about the fragmented approach to anti-corruption at DFID. It talks about a lack of relevant skills. A third of staff are going to be cut at DfID; maybe they already have been, I do not know. How can you add to those skills if you are cutting staff? It talks about a failure to consult adequately with local communities who are supposedly benefiting from the aid. Well, that is easy to address, but I know that DfID has been criticised in the past by the National Audit Office for not going out into the field frequently enough. In fact, I understand that the figures on that were really quite shocking on how often DfID officials went out into the field. It talks about the need to stage unannounced visits and spot checks, to be reactive. Then it also raises the issue that I have already mentioned of how can you oversee if 34% of your aid is going via the World Bank and the IMF. You are dependent on those organisations' oversight.

But just to go back to what seems to me an insoluble quandary, you have the new anti-bribery legislation that has now been adopted in Britain, so you are going to have more and more cases that actually need to see investigation by British police because British companies are going to be going to Africa and paying bribes. That is going to require people. That is going to require resources and skills, and at the same time apparently the counter-fraud unit at DfID has had its numbers cut. So how is DfID—which is raising its aid to 0.7% by, what is it, 2013 or 2015, I do not know which one—going to get that money out of the door and police it? The obvious way to get large amounts of money out the door is to give it as direct budgetary aid, but that means very little oversight unless you trust the Auditor-General in the country concerned and, as the IACA report says, that is often a mistaken assumption to make. You are either going to have to do it as direct budgetary aid, which you cannot then monitor, or you are going to have to give it to the multilaterals and then you are depending on their processes, or you are just not going to give it. But you have to give it because you have to meet 0.7% aid, so I do not understand how you square that circle.

Q414 Lord Forsyth of Drumlean: I was just a little bit unsure of what you were saying. You are saying you think that DfID is much better and you are citing as an example of that the creation of the Independent Commission on Aid Impact. You are contrasting that with the previous Government. Do you think this is because of the new Secretary of State and because of the new political leadership and, if you think that, do you think that really is going to make a big difference? Because if the inherent culture in the organisation is, as you have been indicating, driven by the idea that what matters is inputs and getting the money out there, is it really going to change? To what extent do you think these things are cosmetic and that the culture within DfID and within other aid organisations remains the same?

Michela Wrong: I think when the Conservatives came into power they were very much committed to this 0.7% target. I think they regarded that as a moral commitment but also I think they are very aware that the constituency that tends to not want to vote Conservative because it sees them as the "nasty party" rather likes aid, young, progressive voters. Aid is an important corrective to this "nasty party" image that the Tories suffer from. I think being tough on corruption goes quite deep in Andrew Mitchell's ethos and he wanted to show that DfID was going to be more transparent, more open, make more of its results and findings and figures available on the website. The IACA thing is just a watchdog and it has issued its first report. The report has highlighted certain grave concerns, but the IACA does not have any powers to address them.

Q415 Lord Forsyth of Drumlean: No, sorry to press you; but my question is, in the first part of your answer, you are almost suggesting that all of this is a bit of a gimmick, it is a bit of a way of demonstrating a particular approach and image, whereas when you were talking earlier, I thought you were giving DfID credit for having changed its whole approach. That is really what I am trying to get from you. Do you think that there really is a cultural change of approach or is all of this just superficial window-dressing?

Michela Wrong: Well, how much of a change of approach can you have if you are a department that is committed to spending a certain amount of cash every year and disbursing it in the form of aid? You have to spend that money.

Q416 Lord Forsyth of Drumlean: Hang on, that is my question—

Michela Wrong: No, your commitment is to spend that money. That is your aim in life. That is your raison d'être. I would argue that you can and should police it more carefully. What I do not believe is you can police it more carefully while cutting staff.

Q417 Lord Lawson of Blaby: I would like to come on to that because I may be completely wrong but my impression is the DfID budget combines two elements. It combines the handouts but it also includes the administrative costs. That is part of the overall budget, isn't it? The 0.7% is the total DfID budget. What I cannot understand is why, because this is the logic of what you are saying, is there not some diversion of the DfID budget—it would not have to be a huge one—away from the cash handouts, maybe the cash handouts to the multilateral organisations, for example, to improving the quality and quantity of the staff on the ground? Why doesn't that happen? In fact, they are going in the opposite direction. I do not understand it.

Michela Wrong: I can only share your puzzlement. It seems to me obvious that if you are going to disburse more money you have to have more staff, either that or you will—

Q418 Lord Lawson of Blaby: More and better staff maybe?

Michela Wrong: Well, what DfID would say is that is why we want to move to direct support, budgetary support, because then you do not need more staff. You are just handing the money over.

Q419 Lord Lawson of Blaby: But you do need more staff for the reasons you have indicated?

Michela Wrong: I would say that but I do not work for DfID. They would say, "No, you have a relationship of trust. You have worked with these people. You have built up the accountability institutions of that country and, therefore, you can hand over a larger wodge of money to these people in the sure understanding it is going to be well spent". I would say that that is a huge leap of faith and actually that is a decision that I am afraid will often be taken purely for reasons of pragmatic convenience and staffing pressure on DfID, I would suggest.

Q420 Lord Hollick: Are you saying that even in the best run of DfIDs there is always going to be an element of corruption and that goes with the territory and there is very little you can do about it?

Michela Wrong: I am not saying within DfID itself, although I am sure that—

Q421 Lord Hollick: Use that as a generic for aid giving.

Michela Wrong: The Governments that they deal with, you mean, and the partners they deal with?

Lord Hollick: Yes.

Michela Wrong: Yes, I would say that there will always be a certain level of corruption. It seems to me absolutely natural that that should happen. That is why we all have to submit expenses forms, isn't it? Any organisation that has money flowing through it, there will always be a corruption problem, and I think for all the reasons I mentioned before in terms of it not being your money in any case, it being seen as extra added "fee" money and not of much value to the people who gave it, and all the historical contextual reasons of operating in fragile countries, yes, there will always be corruption.

Q422 Lord Hollick: Given that the corruption undermines the civil society that you are trying to help grow and sustain, would it not make sense in those circumstances just to cut off aid?

Michela Wrong: Well, I think the argument to make is this is a given, it is always going to be there. You can still get things done if you take it on board as an existing problem and you cannot be too puritanical about it because then you would never do anything. I am sure that is what most people in DfID would say and I would echo them. You do not operate in a perfect world.

Q423 Lord Hollick: Does DfID ever turn the tap off when there is a particularly egregious example of corruption?

Michela Wrong: Yes, they certainly do. In Kenya they stopped the primary education programme. But there are times where I have been more critical of them. In Ethiopia, for example, when there was a heavy-handed, draconian human rights crackdown by the Government and rigged elections in 2005, I think it was, DfID went through a rather, in my view, cosmetic procedure where it said, "We are halting direct aid to central government", and they announced that with big headlines—this was under Hilary Benn. In fact, they continued to disburse exactly the same amount of money but they did it regionally through local officials so the Ethiopians did not really notice any impact whatsoever. It was a completely token gesture for public consumption here in the UK.

Q424 Lord Hollick: Just finally, should they be tougher? Should they be taking steps beyond the ones that we talked about earlier to actually make sure that the corruption is kept to a minimum?

Michela Wrong: Yes, definitely. That is definitely the tenor of most of my writing—that they are slow to react, they are complacent, they do not act fast enough and they do not look for it in the first place. If you do not look you will not find. I think the central point is scrutinising aid after you have announced it to the great British public does not benefit anyone. The British Government, DfID, whichever Minister it is at the time, he gets value from going out and announcing that he is helping in a certain part of the world and the African Government concerned gets a lot from that as well. But to then go to the great British public and say, "We have uncovered a scandal and we are going to have to do this, that and the other about it" does not benefit anyone, none of the key decision makers. It makes DfID look stupid. It makes people extremely cynical about aid.

Lord Hollick: But surely doing—

Michela Wrong: Yes, but it is not to anyone's benefit to scrutinise aid carefully.

Q425 The Chairman: I really wonder about that, actually, because there is a lot of investigative press looking for a good story and there is certainly a British public out there that does not like scandals, corruption and waste.

Michela Wrong: Yes, but it is a bad news story. What I am saying is that for the institutions, the recipient Government and the donor Government, it is in neither of their interests to be too closely monitoring aid.

Q426 Lord Forsyth of Drumlean: Sorry to interrupt, but if the donor Government wants to help people in poor countries, surely it is in their interests to ensure that the money gets to those people.

Michela Wrong: I completely agree with you, but I think that there are inbuilt inertias that develop in institutions when there are very few rewards on offer. The other point I would make is if you are working within an organisation like DfID or USAID or the World Bank or the IMF, your career is rewarded by pushing money out the door. Human activity is rewarded. Inactivity is not rewarded. Nixing projects does not get you an upgrade, a promotion. I repeatedly used to hear this phrase from World Bank and IMF people. They say, "No one wants to be seen to be the person who lost Kenya" or, "No one wants to be the person who lost Zaire". Well, if I was losing Mobutu as a client I might be quite proud of myself as a World Bank official person. Even when you interview these people in their 60s and 70s now, they are still looking back with regret on when they pulled the plug on Mobutu in the 1990s.

Q427 The Chairman: You have almost answered the question I was going to ask you, whether this is guesswork on your part or whether it is close observation of what actually happens both in donor agencies and countries and in the recipient countries. It is based on observation, interviews?

Michela Wrong: Yes, absolutely. It was based on observation, very much so, in Zaire because I had the benefit of going to Washington, interviewing a whole bunch of IMF and World Bank officials who had dealt with Mobutu. They decribed the way in which they used to fly to Kinshasa and then occasionally he would round them up with soldiers around the compound and they would almost feel that they were being held prisoner. There was another very infamous occasion, which I mention in my book, where an IMF official had annoyed Mobutu and the soldiers attacked his house in Kinshasa and his wife and children were raped. The IMF quietly withdrew him but did not halt the lending programme to Mobutu. You think, "What does this guy have to do for you to stop lending?". It was always couched in the phrase: "No one wants to be seen to be the World Bank official or the IMF official who loses Zaire". Well, why not?

Q428 Lord Lawson of Blaby: Sorry, what you are saying is there is another dimension to corruption that is maybe even more serious, and that is—it is not financial—the moral and intellectual corruption of most of the people who work in the aid agencies. This seems to me what comes out of your evidence to us, and I have no reason to disbelieve your evidence.

Michela Wrong: Yes, I guess you can call it corruption or you could—I would probably say it is a case of Stockholm syndrome. That is the phrase I used in—

Lord Lawson of Blaby: What syndrome?

Michela Wrong: Stockholm syndrome. If you are a bank official and you are lending to a client, you should not end up over-identifying with his plan to build or buy a new house or extend his garage. That should not be your project. Your project is to make sure you get repaid your money or that the money does not get spent on drugs. Again and again throughout my career, in which I have grown increasingly sceptical about aid, it struck me that there is a tendency for aid officials to suffer from Stockholm syndrome, which is a syndrome where you fall in love with your kidnapper. What you get is an over-identification by aid officials who tend to think that the Kenyan Government or the Ghanaian Government or the Nigerian Government's plans are really their plans, there is a blurring of the divide.

The Chairman: Well, these are certainly questions we can ask of some of our later witnesses. I think still on the same general line, Lord Lipsey.

Q429 Lord Lipsey: I want to explore this phenomenon of donor capture, which is what we were going to look at. It cannot just be a few bad people or not enough people or even more than that. There is something more fundamental. It is interesting going over the Kenyan case because we took evidence from Sir Edward Clay. This £1 million that we have back from them would never have happened if Edward Clay had not blown the whistle on what the Kenyan Government was up to, and he is still fighting away with DfID, which keeps sending letters to us saying it is all absolutely fine now and Clay sends letters back saying it is not. It is not incidentally either confined to government donors. I do not know if you saw that very interesting report by MSF—Médecins Sans Frontières—the other day in which they admitted they are making compromises the whole time in order to get their people in and, in fact, paying part of their money as taxes to government in order to be able to give aid. I would like to draw you out more on what aspects are concerned. You can imagine some of them; for example, if you are a DfID official and it is your programme that goes nuclear, you are the one who may be before the parliamentary Select Committee. What is it that causes them not only to behave in this way but then to suppress what they can perfectly well see to be the truth?

Michela Wrong: Well, we have not mentioned Bob Geldof here but the context of a lot of the aid relationship in Africa really was laid down during the Band Aid years. I remember it really being summarised very well by a Kenyan sub-editor on a newspaper I was working for. He said, "You know what, I have realised over the years that you aid donors need to lend to us more than we need to be lent to". I thought it was a perfect quote. There is an element to which there is a humanitarian imperative now in place that seems to act across the political spectrum and it is a weird mixture of left-wing utopianism and post-imperial guilt complex. It is all played upon by the NGOs and at times you feel there is this extraordinary obligation. We can come back to the issue, but this is why I would be against enshrining the 0.7% limit in law. It seems to me that that just encourages it. It locks DfID into a relationship where it has to obey that humanitarian imperative.

I do not know how much you want to talk about the whole Band Aid thing, but over the last 25 to 30 years I think you have seen some increasingly personalised relationships growing up between certain key presidents in Africa and DfID. These are people that we know very well now, Yoweri Museveni in Uganda, Meles Zenawi in Ethiopia, a series of Tanzanian presidents, the Kenyan leadership, and Paul Kagame above all in Rwanda. It is a very emotional relationship now, I think, that has developed. These are friendships that have developed and I think that does not help.

I have interviewed most of these presidents as a journalist and they are damned impressive people often and they have been through some terrible, terrible things. I think there is a feeling in DfID that these men have taken on extraordinary challenges and tried to do their best and are really genuinely trying to reach the poorest of the poor, to raise health and living standards and feed the hungry. I think people at DfID often have invested so much of their faith in these leaders and what I see is these inspirational leaders who are increasingly showing their authoritarian true colours and who are emerging as presidents for life. They were not when they first got in. Often there are no dauphins visible in many of these countries. I was at a briefing recently where an expert on Ethiopia—I think he was German, it was a Chatham House briefing—said, "I think we can now count the period of multi-party democracy in Ethiopia as well and truly over" and I first thought, "That seems a bit harsh", then I thought, "No, he is right, of course it is over. There is no multi-party democracy in Ethiopia". Human Rights Watch has detailed how the regime in Addis Ababa uses aid, British aid, food aid, fertiliser, technical help for farmers, to make people vote for the ruling party at a local level and keeps its farmers in line. All these fertilisers do not tend to end up in pro-opposition areas, mysteriously enough. These are longstanding relationships now and I think we are tending not to want to look at the reality of these strongmen who are emerging in Africa.

Q430 The Chairman: How would you avoid that kind of development happening?

Michela Wrong: I think you have to be tougher on them. I think it is time that they realised they are no longer donor darlings. Particularly the relationship with Kagame, who is an incredibly impressive man, if you have ever met him, and God knows that country came through a terrible trauma and needed help, but this is now a regime that has not once but several times sent assassination squads out to the UK, out to South Africa, to bump off members of its opposition who are exiled abroad. That makes me very uneasy. I am very uneasy at the way that there are now no NGOs of any real independence operating in Ethiopia. I do not believe there will ever be a free and fair election in Ethiopia again. These are regimes to which we are giving a lot of aid. I find that very worrying and, as I think I said in my testimony, it is not beyond the realms of possibility that the Meleses and Musevenis of today will be the Mubaraks and Gaddafis of the future.

The Chairman: We will come back specifically to the 0.7% later, but meanwhile can we just touch on one other subject?

Q431 Lord Best: It was the new lot of donors like China who are playing the whole thing completely differently, roads in return for access to raw materials, and getting a huge return, no doubt, on any investments that they are making. Is this going to avoid some of the problems that our way of doing aid has led to? Is this going to be good or bad for the countries that are recipients of these new forms of aid?

Michela Wrong: I think at the moment we are going through an experimental period because I think a lot of African countries have said, "Okay, now we can give two fingers up to donors who are giving us an increasingly hard time on corruption and governance issues, and 'yah-boo' sucks, we do not need you and we do not need the IMF". In Angola's case, "We do not need the IMF, we will go to the Chinese". But all of these experiences are proving much more tricky than originally expected. They are proving more tricky for the African Governments who signed these often totally untransparent deals. I am told that the main hospital in Luanda, which was built by the Chinese, opened and immediately closed because it had been built so badly that it is dangerous, it is unfit for purpose. Whichever Chinese company built that, there has clearly been disappointment in terms of the materials it used. They are not passing on skills. They do not appoint local Africans. I do not know about their maintenance contracts but that remains to be seen. There has been some very strange stuff going on in Zambia where the Chinese tried to intervene in the political process and the winner of the election had been very vocal in being the anti-Chinese candidate. There have been all sorts of strange things happening with the mines, and Chinese new directors ended up opening fire on Chinese labourers and going to court because they do not have a concept of labour relations. In Zambia, believe it or not, the unions have a strong tradition.

I think we are going through this experimental process where both sides are realising that this is not quite the panacea that they thought at the start. African Governments and Parliaments are getting much more feisty, as is civil society, so they are holding the Governments to account and saying, "We want to see the detail of these deals. You cannot just go off and sign them and not tell us what the clauses are".

I also think China's position on this is going to change. China wants to be embraced as part of the world community increasingly and every two years there is an international anti-corruption conference staged. Basically, it is organised by Transparency International, the anti-corruption group. The Chinese, interestingly enough, send delegates to that and I have shared a podium with them. They want to be included. They are not tolerant at all of corruption within China. I was at a conference recently where there was a Hong Kong expert and he revealed that there are 500 Chinese officials on the run in Australia, former government officials who are on the run, because they are wanted for corruption, and the Chinese are trying to extradite them to face trial in China. I think that it is moving, things are changing, and I think the Chinese were seen as the ghost, this grotesque monster. Companies here say, "Well, if we do not go in and offer sweeteners or friendship payments all the contracts are going to go to China and they just pay bribes hand over fist". I do not think that is going to be the scenario long term so I am not as negative about this as most people are. I think it is a positive influence. The Chinese are going to build Africa's infrastructure, which increasingly the private sector does not have the means to do and donors are very wary of, often because of corruption experiences that they have had in the past building dams and major infrastructural projects.

Q432 Lord Best: Is it much to do with aid under that description or is it really a trade deal?

Michela Wrong: Yes, the Chinese do not see it as aid. They do not like the word "donors" apparently and they just see it as, "We will give you the infrastructure you need to join the 21st century and in return you are going to give us access to the minerals and the resources that we need". They see that as a fair exchange, yes. I think that is also why African Governments are responding in a very positive way often because they find the break out of the sort of colonial/neo-colonial relationship very refreshing. It is free of baggage and it is just a contract.

Lord Best: Indeed, yes.

Q433 Lord Moonie: Do you believe the UK should have an aid programme other than provision of short-term humanitarian disaster relief? If you do, what do you think its aim should be?

Michela Wrong: Yes, I do. I am not someone who thinks we should just scratch it and throw it all away. I welcome the narrowing of recipients that was announced by Andrew Mitchell when he recently said that aid was going to go to fewer countries. I thought that was a good thing. I still have question marks over many of the countries to which we are giving aid. I think I have made my worries clear about the donor darlings, which I would describe as Tanzania, Ethiopia, Uganda, Rwanda—not so much Kenya, because I think we have a very combative relationship with them, and I think that is a good thing, but the other ones. I think that increasingly to me they have more than a tinge of the Cold War relationships about them where really we may wrap them up in humanitarian language but we are really talking about geostrategic concerns. It does not really matter to us that these regimes have dodgy human rights records because we are very worried about fundamentalism in the Horn of Africa and these are our allies in that struggle against encroaching fundamentalism coming from Somalia. So I think there is a certain hypocrisy about what is going on in that area of Africa.

The other area of concern is that I find it strange and depressing that Nigeria is still receiving I think it is an annual £250 million worth of British aid. Nigeria is the seventh biggest producer of oil in the world and it is bidding for a UN Security Council seat and is a regional military power, and I am constantly meeting Nigerians members of the elite whose education and accents put me to shame because they all went to wonderful private schools in the UK, and yet we are hearing DfID is paying for primary school education. We are rewarding misgovernance, it seems to me, in Nigeria.

In terms of future aid programmes, it seems to me that we are having an old-fashioned debate here, really. I find it hard to imagine that in 10 years' time we are still going to be having these discussions. I see all these hyper-educated bright young Africans, who often have been educated in the diaspora, going back to Africa, and you also see the growth rates of the last 10 years. They are not necessarily as encouraging as they seem on the surface because a lot of them are about commodity prices. There has been a boom in commodity prices thanks in part to Chinese interest. But I just cannot believe that in 10 years' time we are going to be having this debate anymore. It seems to me that aid just is not going to be that central to Africa's future.

I quoted earlier on in my submission Stephen Ellis, an academic who has written an excellent book on Africa, talking about development being like scaffolding that is still up there; the building is not finished and the scaffolding is still up. I think I see it as the stabilisers on a bicycle, a child's bike, and the child's bike is now a man's bike but the stabilisers have now been built in as part of the framework. It is time to take the stabilisers away or at least discuss taking them away. I think this is the problem, where is the built-in obsolescence? Aid should never be seen as something that is permanent. I was listening to Kenyan whistleblower John Githongo, who was talking by video link to Busan where there is an aid conference taking place. He said, "In 2005, you said, 'Let's make poverty history'. When will you make USAID history? When will you make DfID history?". It seems to me that we are over-emphasising, we are over-stressing the role of aid, and we never seem to—these Governments in Africa that have 40% of their operating budgets coming from donors, not just DfID but from donors, and in the case of Museveni he has been in power for 25 years, when does that economy begin to run on its own oil? That has to be the question.

Q434 Lord Lawson of Blaby: What you have been saying is, I find, very persuasive, but to some extent it is generalities. I am not criticising you, but we are a committee that is going to have to make recommendations. In your judgement, what are the two most useful specific recommendations that you think this Committee could make? If you would like to—

The Chairman: Yes, I was going to say if you would like to write to us about that, that saves you giving an answer off the cuff.

Michela Wrong: Yes.

The Chairman: I think clearly from your reflection it might be better if you did write.

Michela Wrong: But it will not be two, that is the trouble.

The Chairman: We will settle for 10.

Michela Wrong: It is a big ask, as they say.

The Chairman: Will you write to us, please?

Michela Wrong: Yes.

Q435 Lord Hollick: Just following up on the same general territory, we have heard from a number of witnesses that they believe that the private sector has a much greater role to play, possibly in partnership with local companies. How would you see that?

Michela Wrong: Yes, I agree in that I look around at the things that have transformed Africa—I have now spent 18 years writing about it—and I see massive changes, extraordinary changes, but a lot of them seem to have been private sector led, although I know that in some cases there was a little bit of seed money that went in in terms of aid. But the spread of the internet, the rise of the private radio stations, the mobile phone, we all know about that. These have been transformative in their impact so I think, yes, I see the private sector as playing an increasingly important role, definitely. I suppose that one looks at what exists on the ground and African entrepreneurialism is an absolute natural driving force. When all else has been crushed and destroyed, there will always be a marketplace somewhere and people selling tomatoes with energy and gusto and huge skill. I think that is something that is going to come through. What you have seen is thanks to the structural adjustment programmes, which have had a very bad press in the past, and things like the freeing up of media ownership that African Governments finally agreed to, the private sector has the wind in its sails and is transforming things.

Q436 Lord Forsyth of Drumlean: I really enjoyed reading your written evidence, which I thought was excellent.

Michela Wrong: Thank you.

Lord Forsyth of Drumlean: You say in that, "The 0.7% target is surely innately problematical in that it places supply before demand, the wrong way to go about things. It risks encouraging DfID officials to turn a blind eye to flagrant abuse in the pressures to get the money out of the door". Could I just explore with you what you think the remedy for this is? I am assuming that you are saying that we should not have a 0.7% statutory target or a statutory target of any kind, is that right?

Michela Wrong: I think a statutory target is—I do not really understand the purpose of it. I do not understand the philosophy.

Q437 Lord Forsyth of Drumlean: You told us what you thought the purpose of it was. You—

Michela Wrong: Well, yes, but there would be an argument, if one really believed that aid worked, for giving much more aid to Africa or—

Lord Forsyth of Drumlean: Can we just stick on the target?

Michela Wrong: Okay, yes, I do not think it is helpful. It is a straitjacket.

Q438 Lord Forsyth of Drumlean: We should not have a statutory target of any kind?

Michela Wrong: No.

Q439 Lord Forsyth of Drumlean: The next question, which is related, is on the 0.7%. You are making the point in your evidence that the emphasis should be on what you get out not what you put in, that you should be looking at what is delivered by the resources. Are you saying that you think that the Government's commitment to increase British aid is mistaken because there is not enough administrative support to get accountability for the funds, or are you saying that there should not be an increase in the overall amount being spent?

Michela Wrong: I suppose my position on this is Collier's position in terms of I do not really have that strong a view because I do not think it makes that much difference, to be honest. We can spend 0.7% or we can spend 0.6%, it is not going to make that much difference. It is not going to transform Africa.

Q440 Lord Forsyth of Drumlean: Well, hang on, you say it risks encouraging DfID officials to—

Michela Wrong: Yes, having that as an absolute fixed target when you do not have the staff to match, when you are cutting back on staff, I think that is unhelpful and possibly dangerous.

Q441 Lord Forsyth of Drumlean: Where we are now, what would you do? Would you increase the money and—

Michela Wrong: Well, I would not cut staff. If you are going to raise spending and disbursement, I would not cut staff.

Q442 Lord Forsyth of Drumlean: If the amount being spent is to be increased, the number of officials should be increased to monitor it?

Michela Wrong: Yes.

Q443 Lord Forsyth of Drumlean: Do you think the amount should be increased?

Michela Wrong: No. One thing we have not mentioned is with the anti-bribery legislation that is coming in, I have occasionally had talks with people like the Serious Fraud Office and the people who are trying to investigate the implications of the various massive scandals that have involved companies operating on British soil. They are already stretched to full capacity. They are not going to be able to deal with all of these new cases. If we are going to give that legislation teeth they have to be able to take on the new cases. DfID is already funding the Metropolitan Police, which has a pretty unique relationship for development and trying to help it. There is going to be a lot of call on DfID's expertise if the anti-bribery legislation has any teeth, and they are cutting the expertise.

Q444 Lord Forsyth of Drumlean: I do not want to put words into your mouth, so two of your recommendations would be abandon the target, the idea of a target, and do not spend any more money on overseas aid, and if you are going to spend it, then increase the number of staff who are monitoring, ensuring they pay the money.

Michela Wrong: Yes. I would also say I would be against the embracing of direct aid budgetary support as an easy solution to these basic contradictory and conflicting stresses and strains.

Lord Forsyth of Drumlean: That is four recommendations.

Michela Wrong: Yes, okay. I produced some.

Q445 Lord Moonie: Can I just follow up on that? Do you think that this concentration on bribery at home is misplaced, compared to what they ought to be doing in the spending of aid in terms of the volume of money involved, for example?

Michela Wrong: No, I am quite keen on anti-corruption, but then I have written two books on the subject. But I do think—

Q446 Lord Moonie: Don't you think it is going for the easy target?

Michela Wrong: No, well what people say in Africa, and it is true, is that it takes two to tango, and there are a lot of lawyers and businessmen and people who travel between here and Africa all the time who make it possible and make it very easy, and the shell companies that are not policed, not examined, our system continues to make these things pretty easy to do. So I think that is the emphasis, and if we do not do it the Americans will do it for us, as we have seen with the BAE case. They are relentless and quite annoyed with the Brits for having taken a soft line on many of these cases.

Q447 Lord Lawson of Blaby: In the rather depressing, but I am sure entirely accurate, general picture that you have given us, I was struck by the one bright spot it seems to me that you found, which was the emergence of a well-educated, maybe often western educated, African elite who you thought would go back and they would in fact do a better job in the governance of their own country at various levels than can be done under the existing regime; this marriage between the donor agencies and the donor darlings. If that is so, do you think there is a case for more of DfID's money, if it is going to have any money at all, being deliberately spent on providing scholarships and other assistance for the most promising Africans—because we are focusing largely on Africa—to come, say, to British universities, British colleges, maybe British schools, in order to foster the growth of this elite which is, it seems to me from what you are saying, the best way forward for Africa? There might be a side benefit for us, it might make them, you never know, more well disposed towards the United Kingdom if they spent some time here, though that would not be the main point of it.

Michela Wrong: Yes. This is where I suddenly hit a blank spot because I suspect some of these programmes already exist. I just do not know. I know that there are many scholarship programmes; who they are being organised by I cannot tell you.

Q448 Lord Lawson of Blaby: I suspect that what happens, but we need to check it, is that if universities do this it comes from the education budget which is constrained, whereas the DfID budget does not touch this at all as far as I am aware. Do you think this might be—this is my question—a better use of DfID money than many of the uses to which it is put at the present time?

Michela Wrong: Yes, I think it is a valid use of DfID money but I would need to examine it more. I know that the US Government, for example, has a leadership programme where it takes young, promising Africans, at very regular intervals and for several months, and they tour America and go to Congress and get introduced to all sorts of interesting aspects of the US, understand how the US Government system works. I know that there is a leadership programme here but I do not know who funds it. I do not think it is DfID but I am afraid I cannot tell you. But, yes, it is very valid. I think Africans put a priority on education so I am constantly meeting—

Q449 Lord Smith of Clifton: In the same way as you are sceptical about how we choose projects to aid, would you be confident that those students being put up for these scholarships are being fairly assessed and promoted, or would they be all part and parcel of the friends and family network?

Michela Wrong: Well, there are objective ways of choosing them, I imagine. I know in journalism there are endless prizes now for good journalism and it is quite interesting, because I am often asked to be a referee or play a role in suggesting people. There is an Astor programme for example, where a major prize is given to an East African journalist. There is an awful lot—

Q450 Lord Smith of Clifton: How do you know that the prize-winner has written it and not someone has written it for him?

Michela Wrong: You do not, but that applies to everything, doesn't it?

Q451 Lord Lawson of Blaby: Does this American programme that you were talking about, this leadership programme, does it do any good?

Michela Wrong: Yes, I think it does.

Q452 Lord Lawson of Blaby: We do not have anything of that sort, do we?

Michela Wrong: I do not think we do, but I do know that there is a system where people are invited and there is a sort of series of lectures, but it does not last as long; it is much shorter and more focused. But I do not know who funds it, I am afraid.

Q453 Lord Moonie: Are you unfamiliar with the Ministry of Defence's programme which takes senior officers and attempts to instil—

Michela Wrong: I think that is very systematic, yes, and that has been part of trying to train up the security forces.

Q454 Lord Moonie: Does it do any good?

Michela Wrong: This touches on something that in a way was included in your questions, which is that it can do good but that can also come with a sting in the tail in that you can then have very effective police forces cracking down on an opposition leader in Uganda, for example.

Lord Moonie: That is what I was afraid of.

Michela Wrong: Yes. Recently the head of the opposition had teargas sprayed in his face after having first had his arm broken in a previous incident, and it was by British-trained police forces, who did the job very effectively.

Q455 The Chairman: Can I just ask you to go a little bit further on a subject that you have already touched on but it is in relation to working through corrupt Governments and so on. Would you recommend that more of the donor aid should be given through NGOs, to avoid this sort of problem?

Michela Wrong: Yes. This is something that I wanted to say. As you have heard, I am a critic of just piling money into direct aid. The trouble then becomes how you disburse, and there is a real problem of capacity absorption even within government, even if you are doing direct budgetary aid. When you are dealing with NGOs, of course, the problem is that they can absorb only so much as organisations, as they are small. I have friends who work in the NGO sector in Kenya and they seem never to have time even to answer their emails or pick up the phone because all the ones who are very good are overwhelmed with offers of money and projects. So there is a real problem in getting a reasonable amount of money disbursed through NGOs. The other problem is that people can be very naive about NGOs and assume that in a system where the president is on the take, the ministers are all on the take, the judges have been bought, the parliamentarians are also eating on behalf of their communities, that somehow an NGO is going to be immune from all of that. Of course they will not be and I am constantly hearing stories, personal stories, anecdotes, of people who say, "Oh, I met this woman, she was running a clinic, she was running a school, it's amazing. I burst into tears, her story was so moving. And then five months later I realised the money had all gone missing". So the NGO sector is as vulnerable to the pressures as the Governments are, and we are constantly hearing stories of NGOs that closed because of scandals. The other thing is that very often the NGO will have been set up by the sister of a minister or the brother of the mayor or a cousin of the councillor because they know that there are certain contracts and certain amounts of money that are looking to be disbursed by the donors and so they will make sure that there is an NGO ready to pick up that contract. So it can be a very cynical business as well.

Q456 Lord Lawson of Blaby: But quite apart from this problem, to put it no higher, with local NGOs, is there not a problem also with major western NGOs? You mentioned some problems with Médecins Sans Frontières earlier in your evidence, but there is a bigger indictment really. I do not know how much credence you give to it, but you will be well aware of Linda Polman's book, *War Games* that is all about the NGOs and how the NGOs have to be in a particular country in order to get subscriptions from the people who finance them, and they are prepared to pay any kind of price to the Governments concerned, for the right to continue to operate in these difficult countries. The money creamed off, which probably does not happen as much with DfID, by the Governments for giving these people permission to operate in these war-torn, strife-ridden countries, is in fact that the money that will go on arms that will be used to suppress the rebels. So is there not a whole range of problems with NGOs too, certainly in difficult countries? Do you recognise the account that she gives in *War Games*?

Michela Wrong: Yes, I read that book and I enjoyed it, and I thought it painted a picture that I recognised having operated in some of those places that she has visited. I think Collier once said to me, and I quoted him in a book, if you pour money into a system that has leakage you are rewarding the system, so if you are pouring money into an area where there is a war going on, or rebel movements operating, they are going to skim it off. They are not going to let it be distributed until they have taken their share, and since they are waging a war, whether it goes on military spending or just fills the stomachs of the soldiers, you are essentially funding and fuelling a war. It may not be all your money that is going into that. They do their best, these international NGOs, but there will be loss and skimming will take place, because that is the nature of the area you are operating in, yes.

Q457 Lord Moonie: You were describing the work of NGOs. When I was doing my training in medicine 40 years ago, one of the more radical views was that it was impossible to get an objective view of problems from somebody who benefited financially, personally, from doing it. Do you notice this in generality among NGOs—that the maintenance of their own organisation becomes a more central tenet than the original humanitarian one?

Michela Wrong: I think that is true of any organisation. I gather the people who are occupying St Paul's now have endless discussions about discussions and meetings and more meetings and there is not that much discussion about bringing down capitalism anymore. This is the nature of human organisations.

Lord Moonie: My hope is that one day people will benefit from past experience rather than their mistakes.

Michela Wrong: I think that every aid agency, whether it is governmental or independent, at a certain stage tends to lose sight of the fact that they are supposed to be committed to their own obsolescence and that in an ideal world they would not exist. It is just normal, because people have career structures. They intend to stay working there. Either that or they leave, and I did encounter in the field an awful lot of people in their 30s—it seemed to happen about mid-35, 36—where they suddenly thought, "I am just making things worse, what am I doing here?", and then they would leave that sector completely.

But I have a lot of friends who are in the NGO sector and I admire them a lot and I like them very much, but, yes, the general critique I would make is it is an industry and industries tend to—

The Chairman: I think we understand what you are saying.

Q458 Lord Tugendhat: The subject is coming back home, as it were. Do you think British taxpayers understand and support the thrust of British aid policy and in particular its engagement to fragile states? What do you see as the main challenge to sustaining public support to the aid programme?

Michela Wrong: I have always thought the whole DfID abbreviation kind of hid the department, in a way, from the British public. I do not think that if you went out on the street and asked most people walking by what is DfID and who runs it, that they would know the answer. I really would be very surprised. I think also this is a sector that is jammed chock-a-block with abbreviations and MDGs and the IACA and SFO. Most people do not understand what this means, and they really do not know what the difference is between project aid and programme aid and the IMF and the World Bank. In the British press the only people who seem to write seriously about developments, and here I have to confess an interest, are the *FT*, which does it very well and has a stable of people who do it very well, and Larry Elliott does it for the *Guardian* and the *BBC* World Service. But most people here do not listen to the *BBC* World Service. So I think there is a real comprehension gap, in part because of poor media coverage. I think most people want to help. What surveys tend to show in the past is that about 70% of the British public supports aid, and then an equivalent number, 70%, are convinced that it is going to corrupt venal people in Africa and not reach its intended recipients. So there is a level pegging there of scepticism but a real desire to help.

My own view is that, long before this credit crunch and crisis came along, DfID had a very nice time of it in terms of public profile and got off lightly. I think that that time is coming to an end, because as we all suffer these horrible, painful squeezes every element of the budget is going to be looked at more closely.

During the looting that swept across London, Manchester, Salford, everywhere, I think DfID were lucky that nobody stood up and said, "How come we're cutting police recruit numbers and salaries here but we are upping aid to Uganda's police?", for example. We are happily recruiting police in Africa or helping people recruit, but we are not doing it here. These direct analogies are generally not being made in the press here, and I think DfID has got off lightly. I do not tend to write those articles myself, because I do not want to go into a *Daily Mail* rant. As you may have realised, my position here is one of scepticism but I hope is one of nuance and I do not want to bang on certain obvious drums. But I do think that a period of greater scrutiny is coming, and maybe that is healthy.

Q459 The Chairman: Perhaps we can conclude there. You have been somewhat critical in the last answer of the media, but as one of the media yourself I think you have done a lot to try and reduce the comprehension gap, if I may say so, and based on your practical experience over many years it has been a very helpful session for us. You have certainly given us thoughts and examples that we will take up with later witnesses.

Could I just ask you one thing? You have put a lot of emphasis, quite understandably, today on the problems. We have asked you two or three times what your particular solutions are. You, not surprisingly, hesitated in order to give a thoughtful answer. If you have further points that you would like to make to us as a result of this session it would be very helpful to have them in writing.

Michela Wrong: Okay. Thank you very much for giving me the opportunity. One thing I would like to say is that the problem with being a journalist and a writer is that you do not design policy. I am often criticised by my friends who do work in policy or work in the NGO sector, who say, "You are very good at criticising but you do not come up with positive solutions".

The Chairman: Don't worry. I think a lot of Ministers and politicians do exactly the same.

Michela Wrong: Yes, I would say that is my job. You have to have people who sit there and carp and that is a helpful role as well, but I will do my best to put forward some proposals.

The Chairman: Thank you.

Michela Wrong— Supplementary written evidence

Dear Sir,

During my November 29 oral testimony before the House of Lords Economic Affairs Select Committee examining the economic effectiveness of aid, I was asked to produce a list of concrete policy recommendations.

They are included below, and are premised on a few basic tenets, namely:

-- that much aid – in particular direct budgetary support – currently serves to prop up predatory elites,

-- that aid is by its very nature vulnerable and prone to corruption,

-- that aid's impact on economic growth rates is difficult, often impossible, to prove,

-- that Africa's traditional 'donor darlings' are becoming increasingly complacent and authoritarian,

-- that NGOs in societies with weak institutional checks and balances are not themselves immune from corruption,

-- that DfID's duty of accountability, in light of all of the above, is not only to the world's poor but also to the British taxpayer.

Recommendations:

1. The 0.7 per cent of GDP minimum aid target should not be enshrined into British law, on the grounds that aid is a political tool rather than an undisputed good. Future British electorates and the governments they choose must enjoy the freedom to determine its use,

2. DfID's push to disburse an ever greater share of its funds via direct budgetary support to be halted and reversed, with greater scrutiny applied on a case-by-case basis to decisions to allocate aid in this form,

3. DfID resources dedicated to anti-corruption work to be increased, and to be kept in strict tandem with future disbursement levels. If aid rises, then so must the budget allocated to its policing and monitoring. DfID's Counter-Fraud Unit and Internal Audit Department, in particular, must be allocated budgets enabling them to recruit staff with the specialised financial understanding and forensic skills required for serious anti-corruption work.

4. Ever closer collaboration between DfID and the FCO,

5. DfID grants and loans to be conditional on a system of unannounced spot checks on projects in the field by DfID staff,

6. DfID to commission external audits for larger programmes from accounting companies which do not have established track records of work with recipient governments, as recommended by the Independent Commission for Aid Impact (ICAI),

7. DfID to make more systematic use of participatory community monitoring of aid (cf ICAI),

8. DfID to press multilateral parties such as the World Bank, which disburse over a third of its aid, to continue improving their own policing of programmes,

9. DfID to exercise its right to audit civil society grantees (cf ICAI),

10. Donors to meet and agree a set of bottom-line human rights-related conditionalities whose violation would trigger an aid programme's automatic review. For example: mass domestic arrests or systematic harassment of opposition candidates during an election campaign, draconian legislation targeting the media and NGO sector, the assassination or violent targeting of government critics and opposition leaders,

11. Donors and recipient governments to agree a theoretical schedule for the reduction and eventual phasing out of aid programmes. This deadline – which might run to 20, 25, 30 years – would not be set in stone. But its annual discussion and examination would serve as a healthy reminder to both parties that their mutual arrangement was neither indefinite nor open-ended.

As you can see, I cite the ICAI report several times, I thought it an excellent piece of work.
I hope this can be of some help,

27 December 2011