

POLICYNOTE

“GIVE A MAN A FISH...” AND FOREIGN AID

Lance Taylor

Lance Taylor is the Director of the Schwartz Center for Economic Policy Analysis (SCEPA) and the Arnhold Professor of International Cooperation and Development at the New School for Social Research.

Lao Tzu's adage is a concise description of the contradictory aspects of foreign aid. “Give a man a fish and you feed him for a day” means that aid can be a dole. But its true purpose is presumably to “teach a man (or a national economy) to fish and ... feed him for a lifetime.” A rule of thumb for successful “fishing” is that the economy should sustain two percent annual per capita output growth. There should also be enough employment creation to keep up with rising population. This combination can make a big dent in poverty by raising average income by 22 percent over 10 years, and 49 percent over 20 years.

Foreign aid has helped launch countries onto two percent or faster per capita growth paths, in diverse policy environments. Limited availability of hard currency is often the crucial bottleneck in a developing economy, for both supply and demand. If effective demand can increase because foreign exchange is available to pay for the associated imports, it can stimulate private sector investment and innovation. At the same time, the imports can bring in essential goods and technologies to raise productive capacity.

Here are some examples:

- In the 1960s and 1970s, illiberal and bureaucratically-planned South Korea utilized capital inflows and American-guaranteed market access to create a formidable industrial

base, beginning with textiles and going on to build the world's biggest integrated steel plant.

- In the 1980s, Chile sidestepped the rest of Latin America's “lost decade” because it received ample foreign assistance from international aid agencies favoring its neo-liberal policy stance. Increasingly sophisticated raw material exports supported economic expansion.
- Several economies in sub-Saharan Africa now have respectable growth rates with support from Nordic and other donors who provided steady aid flows over decades for their own geopolitical reasons.

Two percent growth overall requires higher growth rates of labor productivity in leading sectors. Agriculture dominates poor economies and its productivity growth is crucial, as in sub-Saharan Africa. Despite its adverse effects on income distribution, the aid-fueled Green Revolution clearly increased both land and labor productivity. On the downside, excess food aid can crowd out domestic production. When there is real income growth, the agricultural sector's shares in GDP and employment inevitably decline so it cannot maintain a leading role indefinitely.

At higher income levels, the lead sector(s) must offer increasing returns and opportunities for robust output growth in response to demand. As in Korea, industry has almost always been the engine for productivity growth, though not for job creation. For a sector (or the economy) to generate employment, its per capita growth rate of demand has to exceed its productivity growth. Net job creation usually takes place in services. As already noted, more foreign resources can help raise productivity in industry, so real incomes can rise, and ease the demand constraint economy-wide, so people can be employed. Ultimately, exports and private capital can provide hard currency as in East Asia today, but aid can help get the growth process started.

Such linkages can only be forged by a combination of technocratic top-down policy and spontaneous innovation from the bottom up. State intervention can ease the process. Even in neo-liberal Chile the government consistently supported expansion of agro-exports. Rapid growth has never emerged solely from private entrepreneurship under clear property rights protection as urged by contemporary critics for foreign aid such as William Easterly. Consider the United States in the 19th century. There was active state intervention to support new infrastructure and industrialization. Entrepreneurs from Rockefeller to the Robber Barons paid scant heed to conventional property rights.

If linkages among demand growth, productivity, and employment do not materialize, the economy will not grow and foreign aid becomes at best a dole, and at worst a cesspool for corruption. A hand-out from abroad may cure smallpox or alleviate childhood malnutrition, but it is a hand-out nonetheless. In recent decades many poor economies have seen marked improvements in health care and primary education but have not been able to grow. Even if they succeed on their own terms, people-oriented technical fixes at the household level as advocated by Jeffrey Sachs are not likely to stimulate economy-wide expansion from below.

Foreign assistance is bound to be available in limited amounts. Cost estimates for the widely discussed Millennium Development Goals (MDG), a program for humanitarian contributions, range upward from \$150 billion per year. Current aid flows in principle are on the order of \$100 billion including debt relief; in practice, the transfer is far less. The International Monetary Fund is not allowing many governments to channel forgiven debt toward increased spending on poverty reduction because of its phobia that a modest increase in fiscal outlays will result in uncontrollable inflation (though this view is not supported by empirical evidence).

Even if aid mounts and humanitarian ends are realized, the MDG effort can only be successful if it puts economies on paths to sustained growth. In the past, aid has sometimes spurred growth, but more often it has not. The challenge is to

reshape economic policy at all levels to make it more effective toward the future.

REFERENCES

1. Easterly, William. (2006). *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, New York: Penguin.
2. Sachs, Jeffrey. (2005). *The End of Poverty: Economic Possibilities for Our Time*, New York; Penguin.