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Profit motive can save the world

Alan Wood | December 19, 2008

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KEVIN Rudd will be delighted if Australians spend their handouts from his Santa Claus economic stimulus package on Christmas presents, or just about anything else, rather than saving the money. But when it comes to handing out cash, the intention of the giver and the response of the recipients frequently diverge.

Nowhere is this more apparent than in the field of foreign aid. Since Christmas is a time when appeals for aid donations often seek to exploit the spirit of the season, it also seems an appropriate time to update a long-running debate.

Quite a while ago, trade and development economist Peter Bauer (1915-2002) of the London School of Economics famously remarked that aid was a transfer of wealth from poor people in rich countries to rich people in poor countries. Has this changed? Here is a quote from a recent book by two men from the present generation of US development economists: "Private charities and countries' foreign aid agencies have spent billions annually for decades now, hoping to wipe out poverty. We've seen round after round of debt relief since the 1970s. But despite all this, the average Kenyan is still no richer today than in 1963. Will things really be any different this time around?"

This time around refers to the wave of aid-for-Africa concerts and political grandstanding on aid in forums such as the Group of Eight by prominent entertainers and politicians, including Angelina Jolie, Bono, former British prime minister Tony Blair and his successor Gordon Brown, all practitioners of what British author Patrick West calls "conspicuous compassion" in his book of that title.

The two economists are Raymond Fisman from Columbia Business School and Edward Miguel from the University of California, Berkeley. Their book, published in October by Princeton University Press, has an unusual title: *Economic Gangsters*.

According to Fisman and Miguel, the answer to their question hinges critically on one's view of the role that corruption and violence play in the impoverishment of nations. Hence the title. If corruption and violence are the symptoms of poverty, then the solution is to step up rich-country foreign aid until poverty is eliminated, and corruption and violence will disappear. But if corruption and violence are endemic, no amount of foreign aid will lift a country such as Zimbabwe or Kenya out of poverty. The money will simply enrich kleptocratic elites and entrench corruption and violence.

The leading protagonists in the aid debate are two high-profile US economists, Jeffrey Sachs (who was recently in Australia) and William Easterly. Sachs has long been an adviser on economic development (not always successfully) to governments across the world.

Sachs is a believer in poverty traps and he is not afraid of making a bold call on a policy to end poverty: more rich-country money, and lots of it.

Given enough aid money, together with a grand development plan, its implementation overseen by the UN, poverty can be abolished by 2025.

Easterly agrees with Sachs on the need to tackle poverty, but not with his "big push" solution. Nor is he impressed by the corporate philanthropy, or creative capitalism, approach of Microsoft's Bill Gates.

Of Sachs's approach, Easterly says it is strikingly similar to the ideas that inspired foreign aid in the 1950s and '60s, which influenced the bureaucratic approach to economic development that has been followed since.

After five decades and trillions of aid dollars, the most aid-intensive regions, notably much of Africa, are still poverty stricken, suggesting the big push approach is unlikely to be a great success.

As for the poverty trap, an idea that dates from the same era, Easterly argues it has been refuted by the successful escape from poverty of many societies without much aid as a percentage of their total income, China and India, which had African-style poverty levels as recently as the '80s, being cases in point.

"Fortunately for the world's poor and for all the rest of us, there are much more dynamic forces in the world than UN bureaucrats and their academic advocates," he said earlier this year.

The world poverty rate has declined by half over the past 30 years, and it has had little to do with foreign aid. Chief among these dynamic forces, in Easterly's view, is capitalism. Criticising Gates's attack on capitalism and his call in *The Wall Street Journal* in February for much more corporate philanthropy, Easterly commented that philanthropy had proved awfully weak compared with the profit motive.

He said profit-motivated capitalism had done wonders for poor workers, with the globalisation of capitalism from 1950 to the present increasing annual average income in the world to \$7000 from \$2000.

Contrary to popular belief, poor countries' incomes grew at about the same rate as those of the rich ones, leading to the greatest mass exit from poverty in world history.

With the world plunging into recession as a result of the excesses of financial market capitalism, this no doubt sounds a bit thin these days. But on a longer view, Easterly is right to argue that the parts of the world that are still poor are suffering from too little capitalism.

Direct foreign investment in Africa today, although rising, still amounts to only 1 per cent of global flows because the environment for private business in Africa is still hostile, despite some African industry and country success stories.

Easterly is not opposed to foreign aid for poor countries: on the contrary, he thinks, like Sachs, that the remaining levels of world poverty are a disgrace. But his approach rejects the grand plan and the deployment of the legions and billions of the foreign aid establishment.

Instead, he prefers a multitude of smaller programs that can be much more easily monitored and audited to see what works, and systems that give more economic and political freedoms to individuals to find their own solutions to poverty.

Easterly has history on his side. Even in China, which remains a communist state, rapid economic growth followed the freeing up of its economic life and greater political freedom relative to its earlier totalitarianism, not the nostrums of the foreign aid establishment.

But no escape from poverty is possible while corruption and violence rule and, as the example of Zimbabwe under Robert Mugabe and other Africa nations powerfully demonstrates, the world is a long way from finding a solution. Perhaps our Prime Minister has one?

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