IPA Backgrounder

Australian Aid Policy:

A Case of Lose/Lose, not Win/Win

by Peter Urban

Summary

Australia's aid programme is significant, particularly in the Pacific, totalling (in 2000–01 terms) around $50 billion since 1975. It also accounts for a significant and growing share of scarce national savings.

Despite this, our aid programme has been a dismal failure in the very countries—the Pacific islands such as Solomon Islands and Papua New Guinea—which form the core of the programme. Indeed, the phrase 'failed state' has been used to describe the Solomons, and, by any measure, PNG is also on the brink of failure.

In response to this clear failure of our aid programme in the Pacific, the government has proposed a new aid initiative for the Pacific: co-operative intervention (CI). Will CI succeed or will it, like so much well-intentioned Australian aid before it, prove to be an expensive failure?

To be able to begin to answer this question—a vital one given the importance of the Pacific to our trade, security and foreign policy interests and the fact that aid/CI will cost Australian taxpayers upwards of two billion dollars a year for the foreseeable future—we first have to understand our aid programme: its goals, where it goes, what it does and how it performs. The purpose of this *Backgrounder* is to answer these questions.

Sadly, if our answers are any guide, CI is likely to fail the most important lesson of the history of our aid programme: that aid only helps those countries that are trying to help themselves. If our aid programme continues to support corrupt politicians and/or corrupt political systems, it is doomed to continue to fail.

December 2003, Vol. 15/4, rrp $13.20

Introduction

Over the last three decades, Australia has provided around fifty billion dollars (in 2000–01 terms), in official development assistance (hereafter aid or ODA) to developing countries. While we are, in OECD terms, at best only a middle-sized aid donor (see Figure 1), our aid programme is, nevertheless, significant.

More importantly, at least from a national perspective, our aid programme accounts for a significant share of net national savings—nearly 10 per cent, in fact. The reality is that aid to developing countries, while important in a humanitarian sense, also competes with other government spending programmes for national savings and the tax dollar: a dollar more in aid spending, to put it crudely, is a dollar less that is available, for example, for education or health spending in Australia.

Against this background, and particularly in light of our very low (and declining) savings rate,[1] we need to be confident that our aid programme is delivering the maximum benefits possible, both to the recipient countries, and in terms of our own national interest objectives. To do otherwise would be to short-change Australian taxpayers and developing countries: if, by directing our aid dollar to other objectives, such as education, we can raise GDP in Australia, we will be better off ourselves and we will also have more resources to direct to aid in the future.

The purpose of this Backgrounder is threefold:

- to identify the objectives of (and constraints facing) our aid programme;
- to analyse how we provide our aid (and to whom); and
- to review the performance of the programme.

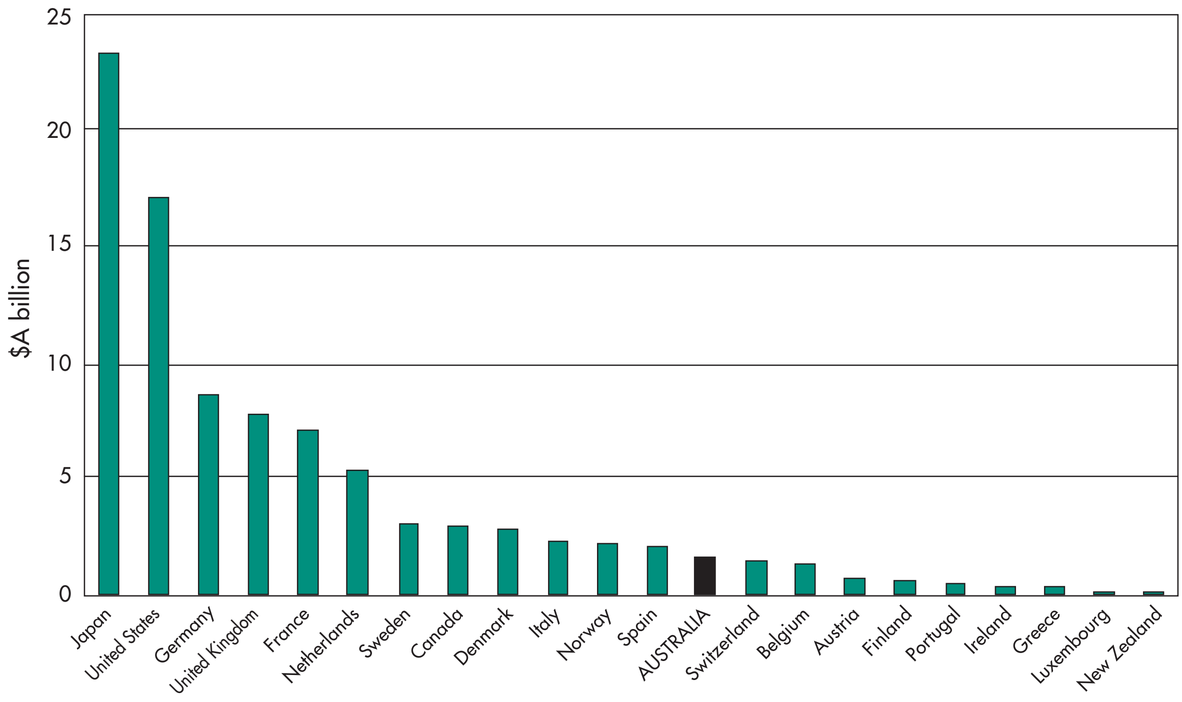
Aid Objectives and Policy Constraints

For most Australians, aid policy is about reducing poverty. In fact, it's not—at least in two important senses.

Most obviously, aid policy isn't about simply reducing poverty; it's about reducing mass poverty. All countries, including relatively wealthy ones such as Australia, have elements of poverty. Aid policy isn't about reducing poverty in wealthy countries. It is about reducing poverty (both short- and long-term) in countries where poverty affects a large proportion of the population—indeed, where poverty is the norm, rather than some isolated problem.

Second, aid policy isn't just about reducing mass poverty. Aid policy is, along with foreign, defence

Figure 1: Australia's Ranking Internationally as an Aid Donor ($A billion)



Source: Statistical Summary 2000-2001: Australia's Overseas Aid Program and trade policy, an important element of any country's international strategy. This fact is particularly important for middle-sized economies such as Australia.

As noted, the private savings rate in Australia is low and declining. As a result, the government has to get maximum 'bang' for its spending buck. Moreover, as a middle-sized power, Australia has limited capacity to influence events internationally—diplomatically, in trade, or to increase our security. As a result, all our instruments of international policy, including aid policy, need to be deployed together in a consistent way if Australia is to achieve its security, foreign policy and trade objectives.

Although the average Australian can be forgiven for not understanding these two fundamental roles for aid policy, of far greater concern is the failure of Australian policy-makers themselves properly to understand the role of aid policy. In the most recent review of aid policy, (titled 'One Clear Objective: Poverty Reduction through Sustainable Development' and prepared by the Committee of Review on Australia's Foreign Aid in 1997), the Simons Report recommended that aid policy should focus on poverty reduction and rejected the broader role set out for aid policy by the Jackson Report (the predecessor to the Simons Report) in 1984. In the Jackson Report, the Committee to Review the Australian Overseas Aid Program articulated, appropriately, diplomatic and commercial as well as humanitarian objectives for the aid programme.

To be fair to the Simons Report, however, the narrowing of aid policy objectives to a humanitarian role reflected the marked shift in aid away from an emphasis on reducing poverty and, over the preceding decade, in favour of a greater trade focus, particularly under Australia's Development Import Finance Facility (or DIFF programme).

In this sense, the clarion call of 'one clear objective' of the Simons Report was, at least in part, a simple statement that while aid may (and indeed does) have a broader set of objectives than simply reducing poverty, poverty alleviation had to be a core objective for aid policy. At the very least, aid has to reduce poverty in the recipient countries.

Against this background, the broad objectives of aid policy are dual: *poverty reduction **and** promotion of Australia's international interests*. Aid policy, however, has to be careful to avoid any direct trade-off between these twin objectives—say, less poverty alleviation in exchange for greater progress in promoting our trade interests. To the extent that we decide to pursue trade goals, for example, at the expense of lowered emphasis on reducing poverty, it is likely that we would be better off using aid funds to support trade directly. A similar argument holds for any trade-off between poverty reduction and security.

Furthermore, as a middle-sized world economy (albeit one which, as a result of significant micro- and macro-economic policy reform over the last two decades, has grown substantially in relative size in recent years), aid policy has to pursue its objectives subject to two important constraints. Australia has limited capacity to impose aid conditionality to influence policies (including economic policies) in recipient countries, and because of the necessarily constrained size of our aid budget, our aid programme has to have clear, but also fairly narrow, objectives.

While the US or Japan (or the IMF) may have the clout to impose conditions when they grant aid and the budget resources to implement broadly-based aid programmes, we have to be more selective and targeted with our aid. Indeed, any attempt to impose aid conditionality on our part would likely risk creating wider foreign and security policy problems. And while aid conditionality may be imposed with the recipient country's interests at heart, the governments of the relevant countries are, if past behaviour is a guide, likely to be resentful and to look for opportunities to take retaliatory action whenever and however possible.

The constraint of the need for a narrowly focused aid programme is particularly important when set against the trend over the last two decades for aid policy to take on broader social and institutional objectives beyond poverty reduction. While these objectives may be important to the long-term development of a country, they can easily diffuse the poverty reduction effort and lead to conflicting goals. More importantly, from the perspective of a middle-sized aid donor such as Australia, they may impose too heavy a burden on the aid programme and can easily lead to conflicts with stakeholders in the recipient country, with adverse impacts on the success of these projects and for our wider security and foreign policy interests. Far better for an aid donor such as Australia to focus on narrower objectives where it can make a clear difference.

The How of Australian Aid

In outlining Australia's aid programme, AusAID (the Australian Agency for International Development, our official aid agency) divides aid into *where* our aid goes and to which *sectors* we provide aid in recipient countries. Both divisions are relevant to assessing the consistency of our aid programme with the objectives set out above, and we will look at each in turn.

As well as the geographic and sectoral divisions of our aid programme, AusAID splits its aid programme into:

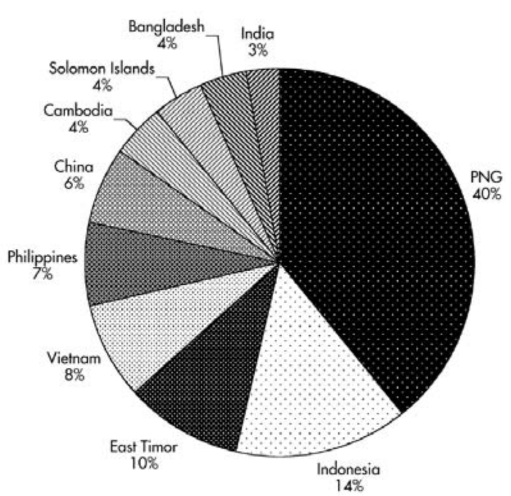
- those projects it delivers itself (its country and regional programmes); and
- aid delivered through other institutions, such as the World Bank.

In 2000–01, the latest year for which AusAID data are available, country and regional programmes accounted for $907.4 million of total ODA of $1623.1 million, or about 56 per cent. Global programmes (such as through the World Bank and World Food Program) accounted for $561.1 million and aid through other government agencies (such as ACIAR) $196.2 million, while running costs totalled $67.6 million.[2]

Of these aid categories, country and regional programmes have been relatively stable, declining slightly (in constant 1999–2000 prices) from $912.4 million in 1998–99 to $907.4 million in 2000–01,while multilateral aid has fluctuated widely over the last three years. In this period, aid through NGOs (and volunteers) increased sharply, from $38.0 million in 1998–99 to $44.3 million in 2000–01. These figures, however, also probably substantially understate aid channelled through NGOs, since some of AusAID's country and regional programmes also use NGOs to deliver aid. When adjusted for price movements, the pattern outlined above varies little: total aid is relatively stable over the period ($1628.1 million in 1998–99 compared with $1623.1 million in 2000–01) and country and regional programmes again accounted for around 56 per cent of the total.

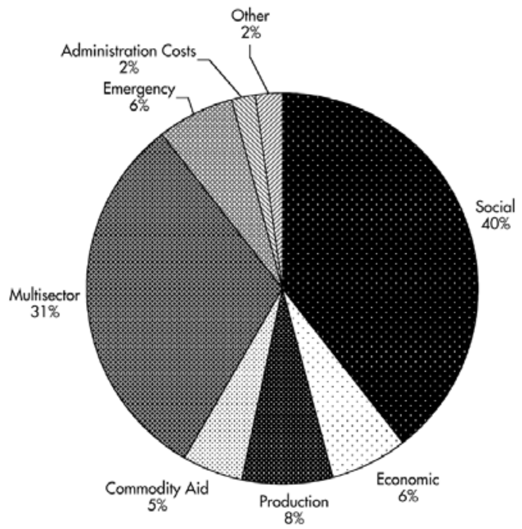
Of total Australian foreign aid spending (at current prices), the bulk of spending is divided between PNG (20.6 per cent or $338.2 million in 2000–01), East Asia (including Indonesia, East Timor, the Philippines, Vietnam and China) which received 30.8 per cent or $504.5 million, South Asia 5.5 per cent, Africa and the Middle East 5.2 per cent, and the rest of the world 28.6 per cent or $468.2 million in 2000–01. While this distribution of country and regional aid, with its emphasis on the Pacific and East Asia, is both understandable (they are our near neighbours) and entirely appropriate from the point of view of our security and diplomatic interests, the emphasis on aid to PNG does stand out: it is in a class of its own. PNG accounts for about 21 per cent of our total aid. More significantly, aid to PNG in 2000–01 was nearly three times that to Indonesia, a far more populous country than PNG and one that rates at least as highly in terms of our trade, security and diplomatic interests. The bias in favour of PNG is even more obvious when its aid is shown as a share of Australian aid to our top 10 aid recipients (see Figure 2).

Figure 2: The Direction of Australia's Aid (Top 10 Recipient Countries)



Source: Statistical Summary 2000-2001: Australia's Overseas Aid Program

Figure 3: Australian Aid by Sector



Source: Statistical Summary 2000-2001: Australia's Overseas Aid Program

In Figure 3, aid flows are broken down by sector. As can be seen, social aid (that is, aid for education, health, population policies, water, housing, etc.) and multi-sector aid account for around two-thirds of our aid. Commodity aid and production aid (including to agriculture) account for only about 13 per cent of our total aid.

Even more surprising: of the social aid, again the vast bulk of our aid is in general rather than specific form. Aid to government and civil society accounts for about 37 per cent of social aid (or about 15 per cent of total ODA) compared with less than 5 per cent (or less than 2 per cent of total) for water supply and sanitation. Indeed, water projects received only $12 million more in aid in 2000–01 than, for example, aid for general government services!

Similarly, while education accounted for approximately a quarter of social aid, only about 40 per cent of this went for basic education, while nearly 25 per cent was accounted for by advanced technical and managerial education. The point here is that with our education aid, the focus is on higher education (much of it delivered outside the recipient country) rather than on primary and early secondary education, where much of the extreme poverty problems arise. As well, many of the recipients of higher education use this training to leave the country and work overseas, with consequent loss of aid benefit to their home country.

Even worse, AusAID has, in many cases, devolved the selection of beneficiaries of education assistance to the recipient country government. In theory, this may be fine, but in, say, PNG, this simply means that the beneficiaries are the 'elite', their children or relatives, rather than the poor. Worse, many of these 'elite' beneficiaries use their Australian-funded overseas education to leave PNG, rather than to help improve the situation in Papua New Guinea.

Table 1: GDP Growth Per Capita in Australia's Top Ten Aid Recipients[3]

Aid Recipient	% GDP Growth Per Capita (1990–2001)
Papua New Guinea	1.1
Indonesia	2.2
East Timor	4.7
Vietnam	5.8
Philippines	1.0
China	8.8
Cambodia	2.2
Solomon Islands	-11.5*
Bangladesh	2.8
India	4.0

*2000-01 only.

Source: www.dfat.gov.au/geo/fs

Performance

As discussed earlier, the objectives for aid policy should be to reduce poverty *and* contribute to Australia's diplomatic, trade and security interests or, as AusAID rather vaguely and nebulously puts it: *To advance Australia's national interest by assisting developing countries to reduce poverty and achieve sustainable development* (apart from being a tautology, the phrase *sustainable development* is too nebulous, as is *national interest*, to form the basis of a practical aid programme). Well, how does our aid programme perform against these objectives?

Since poverty reduction is the fundamental objective for our aid programme, we will take this objective first. We will then consider the trade, security and diplomatic objectives in turn.

Poverty Reduction

In Table 1, we list the top ten destinations for AusAID's country and regional aid. The table also lists the average GDP growth rate per capita for these ten countries over the ten years to 2000–01.

The results are quite remarkable. For AusAID's key aid recipients in the Pacific and directly to our north, average per capita GDP growth has been low or even negative. For two of these countries, Papua New Guinea and the Solomon Islands, poverty has increased significantly in recent years despite substantial Australian aid—in PNG's case, despite total Australian aid of over $300 million dollars per annum (and total aid since PNG's independence of over twelve billion dollars).

Nor is the disastrous performance of much of our country and regional aid restricted to poor income growth. For a number of our top ten aid recipient countries, other development indicators, such as literacy rates and basic health levels, have also shown weak improvement or even deterioration.

The conclusion: in terms of its primary objective—that is, poverty reduction—Australia's aid programme has been an abject failure. This failure is even greater when considered against the background that, globally, over the last two decades we have succeeded in the task of reducing absolute poverty. As noted in a Treasury paper last year:

> We now know how to reduce mass poverty and are doing it.

This doesn't hold for AusAID's aid programme. By sustaining poor governance and misdirected policies in our aid-recipient countries, our aid programme is, in fact, adding to poverty at a country level, not reducing it!

The obvious rejoinder—'yes, most of these countries have done abysmally, but this is not the fault of the aid programme'—is easily rejected. While it may be true that our aid had little to do with the success of China or even Vietnam (because our aid is a very small percentage of GDP in these countries), in the cases of the Pacific island failures in Table 1, our aid accounts for a significant share of GDP. Indeed, in a number of poorly performing Pacific island countries, our aid accounts for over 10 per cent of GDP. At this level of aid, GDP growth performance would reflect any stimulus from good aid performance.

The other obvious rejoinder—that it isn't AusAID's own aid but rather aid channelled through multilateral institutions such as the World Bank or the Asian Development Bank that is the problem—also doesn't stand up to scrutiny. In PNG, for example, both the World Bank and the ADB had given up in the early 1990s because of concerns with corruption and poor governance. The World Bank only returned to PNG under pressure from Australia. Moreover, while an internal AusAID assessment of aid projects co-financed by AusAID with multilateral agencies does point to deficiencies with these projects, these problems typically are of AusAID's own making—poor project selection, lack of co-ordination, etc. The review also noted that the projects also perform, on average, better than AusAID's own projects.

Trade

Over the last decade and a half, Australia's trade performance has been outstanding, with exports as a share of GDP increasing by nearly 50 per cent. The trade performance of our aid programme has, however, detracted from this overall trade success.

There is an old adage: good aid is good trade. The logic behind this adage is simple: by raising incomes, good aid contributes to trade growth. The converse is also true, bad aid is bad trade.

This has been the case for Australia. In PNG and the Solomon Islands, for example, Australian exports increased by only 36 and 17 per cent over the decade from 1991 to 2001. Over this same period, total Australian exports more than doubled. The pattern is also repeated in Indonesia and the Philippines—below-average export growth. Only in the higher growth aid recipients has export performance been average or better. The reason for our dismal export growth in many aid recipient countries is thus obvious: the poor economic performance in these countries. In turn, the poor economic performance reflected the poor quality of our aid.

Security

Of the top ten recipients of Australian aid, five (or half) form an 'arc of instability' and are a major direct concern to our security. Of course, the instability in many of these countries is not the direct result of our aid programme. In some, such as PNG, however, it is (see the Box 'On Our Doorstep').

Moreover, even where there is no direct link between our aid and the security problems we face from these countries (and here I use security in a broad sense to include terrorism and refugee exodus), two significant points can be made:

- if, through better design of our aid programme, we had been able to contribute to stronger economic growth in these countries, we would have likely seen reduced instability in these countries—that is, good aid (bad aid) is, again, also good security (bad security); and
- we have provided too little aid to Indonesia over the last five years. Since the Asian Crisis of 1997 and 1998, Indonesia has faced massive economic and social disruption and is today on the verge of disintegration as a country. Despite this (and despite Indonesia's importance to us as a trade and security partner), we provided only $123 million in country and regional aid to that country in 2000–01, not much more than a third of the aid we provided to Papua New Guinea.[4]

Diplomacy

Australia is resented across the region. Partly, this reflects our links to a colonial past (particularly among older politicians in, for example, PNG). However, it also reflects frustrated expectations, particularly among the youth in these countries, many of whom face severe unemployment and crime problems.

Most of the developing countries of our region have under-performed economically and in terms of wider

On Our Doorstep

If there is one lesson for national security policy that we should learn from September 11 and the Bali bombings, it is the fundamental one: that threats to national security often come as a surprise, but that, after the event, are also rather unsurprising. With our attention firmly focused on terrorism, the risk for our national security planning is that we will downgrade or overlook other risks.

Papua New Guinea is a good example of this danger. It is an obvious launching pad or conduit for terrorist or transnational criminal activity directed against Australia, given the growing political and institutional instability in that country. But the real security threat from PNG is likely to come from internal developments in PNG and a continued failure of Australian aid policy.

In 1999–2000, GDP contracted by 1 per cent. In 2001–02, PNG's GDP is estimated to have declined by 3 per cent. In real per capita terms, incomes in PNG have probably contracted by around 20 per cent over the last five years. Unemployment is high and rising, particularly among the young, lawlessness is out of control and, as a state, PNG is dysfunctional: outside the capital (and even within Port Moresby), most basic services such as police, transport, education and health have collapsed.

Australia shares extensive island and seabed borders with PNG. Within the Torres Strait, there is also freedom of movement of Torres Strait islanders of either nationality between both countries. These movements have increased significantly over the last few years and were estimated at over 50,000 movements in 2001. We can expect to see these movements increase further as more and more Papua New Guineans come to rely on Australian facilities in the Torres Strait for basic services.

While a large, uncontrolled movement of PNG nationals across our borders presents serious risks in its own right, the nature of those movements is also of concern. In PNG, AIDS infection is running at nearly one per cent of the adult population. This compares to an infection rate of 0.1 per cent in the Australian adult population. As a result, a large influx of PNG patients into the Torres Strait health system brings with it the increased risk of AIDS transmission into the Australian health system.

social development. While the poor governance driving the political corruption and development problems in many South Pacific island nations has its genesis in the countries themselves (and some would argue in the culture of these countries), our aid has to be built around this constraint.

While AusAID is acutely aware of this fact, the reality is that our aid programme has not done this in practice. Indeed, by continuing our generous aid in the face of growing corruption in these countries, it has in fact helped nurture and feed the corruption at the heart of the governance and under-performance problems. In turn, this has exacerbated the resentment of Australia across the region. *And again, to put it succinctly, bad aid has become bad diplomacy*.

Conclusions

Given our relatively modest size (in terms of GDP) and our extremely scarce private savings, Australia is a significant aid donor. Despite this, our aid programme lacks clear objectives. While 'one clear objective—poverty reduction through sustainable development' may have a nice public relations ring to it, it is not a clear set of objectives for a large aid programme. Worse, this supposed objective does not address the significant constraints faced by a middle-sized economy such as Australia in successfully implementing a substantial aid programme.

Not surprisingly, our aid programme has been a failure. The extent of the gross failure in terms of all four objectives for the programme—poverty reduction, trade, security and diplomatic—however, points to more fundamental problems than just ill-defined objectives and a failure to acknowledge implementation constraints.

As we saw, the structure of the aid programme was also part of the problem. The emphasis in our aid is on general social programmes rather than on, say, specific water, basic education or agricultural projects. This emphasis partly reflects AusAID's focus on relative as distinct from absolute poverty. But it also reflects AusAID's view that we have to help to get 'institutions' right before we can reduce poverty itself. Unfortunately, given our size, the emphasis on relative as opposed to absolute poverty only adds to the poor focus of our aid programme, while the 'institutions-first' emphasis, because of the fungibility of aid monies, gets lost in the governance and corruption morass that characterises most of our aid recipients.

Far better for us to focus first on specific aid projects directed to infrastructure development (both hard and soft infrastructure)[5] and leave these countries to address their governance problems, cultural as many of these problems are, before we try to change their institutions. Such an approach also reduces the risk of aggravating the resentment felt towards us by many of our aid recipients.

Exacerbating these structural problems is the fact that AusAID makes inappropriate use of NGOs—outsourcing much of the task of implementing our aid when it should be managing this task itself, both for reasons of control and accountability and to increase its own expertise in project-managing aid delivery. Nor is this just a problem for implementation. Unless the NGOs are monitored carefully, they can cause major diplomatic problems for Australia, as the Prime Minister found during his visit to Jakarta last year. While use of NGOs can help leverage our aid spending, the problem is that some (most?) NGOs use their aid delivery role to pursue other social and political agendas, often at direct odds with Australia's international policy interests. It can also add appreciably to administrative costs, with AusAID, the NGOs and their subcontractors all meeting their administrative costs (some of which may be hidden) out of project funds.

Finally, while the country priorities of AusAID's country and regional aid programme (with its heavy emphasis on Southeast Asia and the Pacific islands) is entirely consistent with our trade, security and diplomatic interests, the balance of this aid (dominated as it is by Papua New Guinea compared to Indonesia) is questionable. If we are to improve the performance of our aid programme, we need to rebalance the spending between countries.

Taken together, this points to one simple conclusion: we need fundamental reform of our aid programme as a whole, and not just of the expenditure programme, but of AusAID itself—its management, structure and accountability. Unless we do this, we will continue to waste our aid dollar, with serious adverse poverty, trade, security and diplomatic consequences. At a total cost of over $1.6 billion per annum, we simply can't afford it!

Endnotes

1 Just how low is reflected in the Current Account Deficit (or CAD), which is the deficit of domestic savings over domestic investment. At present, the CAD is running at around 7 per cent of GDP in Australia. This level of domestic savings shortfall is unsustainable.

2 As well, there is an accrual adjustment of -$109.1 million. This adjustment is necessary to ensure that the sum of these components is consistent with the actual total amount of aid.

3 The average per capita growth for low/middle income developing countries of East Asia and the Pacific over the period 1990 to 2001 was 6.1 per cent per annum.

4 The problem of our aid to Indonesia is not so much poor aid, but simply too little to address the problems confronting that country. It would have been far better, from the perspective of the Australian taxpayer, to have reduced our aid to PNG and used these funds to increase aid to Indonesia.

5 The focus should be on areas where Australia has world-leading expertise such as water, agriculture and, perhaps surprisingly, inter-government finance or other areas of need.

About the Author

Peter Urban has worked as a policy economist for nearly thirty years, including as Chief Economist at the Department of Foreign Affairs and Trade, a Visiting Fellow at the Australian National University and a Research Fellow at the University of Pennsylvania. Since 1998, Peter has been a regular commentator in the *Australian Financial Review* and *The Australian* on international economic issues, including aid policy. He has also published widely in professional journals and has contributed to several books on economic policy, notably two chapters of *Industrial Policies for Growth and Competitiveness: An Economic Perspective*, which was jointly edited by Lawrence Klein, the 1980 Nobel Prize-winner in economics.

This Backgrounder is published by the Institute of Public Affairs Ltd (A.C.N. 008 627 727)
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