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## Reinventing foreign aid for inclusive and sustainable development: a survey

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WP/14/033

**Reinventing foreign aid for inclusive and sustainable development: a survey**

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**AGDI Working Paper**

Research Department

**Reinventing foreign aid for inclusive and sustainable development: a survey**

**Simplice A. Asongu<sup>1</sup>**

September 2014

**Abstract**

This survey essay reviews over 200 papers in arguing that in order to achieve sustainable and inclusive development, foreign aid should not orient developing countries towards industrialisation in the perspective of Kuznets but in the view of Piketty. Abandoning the former's view that inequality will fall with progress in industrialisation and placing more emphasis on inequality in foreign aid policy will lead to more sustainable development outcomes. Inter alia: mitigate short-term poverty; address concerns of burgeoning population growth; train recipient governments on inclusive development; fight corruption and mismanagement and; avoid the shortfalls of celebrated Kuznets' conjectures. We discuss how the essay addresses post-2015 development challenges and provide foreign aid policy instruments with which discussed objectives can be achieved. In summary, the essay provides useful policy measures to avoid past pitfalls. *'Output may be growing, and yet the mass of the people may be becoming poorer'* (Lewis, 1955). *'Lewis led all developing countries to water, proverbially speaking, some African countries have so far chosen not to drink'* (Amavilah, 2014). Piketty (2014) has led all developing countries to the stream again and a challenging policy syndrome of our time is how foreign aid can help them to drink.

*JEL Classification:* B20; F35; F50; O10

*Keywords:* Foreign aid; Piketty; Kuznets; Development

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## 1. Introduction

At the 15<sup>th</sup> Global Development Network (GDN) Annual Development Conference, Célestin Monga, Chief Economist and Advisor to the World Bank Senior Vice President stated: *“The main reason for our failure has been bad ideas. Period. Not bad leaders, poor institutions, bad infrastructure. But simply bad ideas”* (Monga, 2014). The golden idea that industrialisation generally reduces inequality in the long-term no longer holds today. Hence, there is an urgent need for policy reversal in development approaches based on this idea. In this light, the title of this essay can be translated into one sentence: in order to achieve sustainable and inclusive development objectives, foreign aid should not prepare developing countries for industrialisation in the perspective of Kuznets (1955) but in the view of Piketty (2014). The recently celebrated *‘Capital in the 21<sup>st</sup> century’* has debunked a previously celebrated Kuznets conjecture of an ‘n-shaped’ nexus between inequality and industrialisation. Piketty’s ‘u-shaped’ relationship highlights an important reversal if the post-2015 development agenda of sustainable and inclusive development is to be achieved<sup>2</sup>.

In light of the above, the notion that inequality would naturally fall with maturity in industrialisation has become a bad idea. Hence, growing inequality in the long-run would seriously compromise the post-2015 development agenda unless policy acts on industrialisation and inequality concurrently (United Nations: UN, 2013, pp. 7-13)<sup>3</sup>. One inference and one puzzle result from the above narratives: respectively, the intuition that inequality may be a better policy variable than growth and the concern of why foreign aid should focus more on inequality than on growth in poverty reduction. Synthesizing the

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<sup>2</sup> There is a growing literature on inclusive and sustainable development (Epstein et al., 2011; Allen & Ndikumana, 2014; Asongu & Nguena, 2014; Anyanwu, 2011, 2013ab; Balamoune-Lutz & McGillivray, 2009; Balamoune-Lutz, 2007; Balamoune-Lutz, & Lutz, 2005; Anyanwu, 2014ab).

<sup>3</sup> The post 2015 agenda include inter alia: ‘leave no one behind’; ‘put sustainable development at the core’; ‘transform economies for jobs and inclusive growth’; ‘build peace and effective, open and accountable public institutions’ and; ‘forging a new global partnership’. In essence, poverty eradication and the transformation of economies by means of sustainable development are keys to post-2015 development agenda on priority transformations.

inference and the puzzle leads us to a question: is inequality a better policy variable than growth in the fight against global poverty?

Foreign aid poverty reduction strategies have centred on boosting growth and governance<sup>4</sup>. With stylized facts substantiating “immiserizing growth” (Bhagwati, 1958)<sup>5</sup>, a growing stream of the literature provides strong support for the crucial role of *inequality in poverty-growth transformation* (Adams, 2004; Fosu, 2011, 2014; Kalwij & Verschoor, 2007; Thorbecke, 2013). There has been emphasis on the need for policy to properly understand growth elasticities (Adam, 2004), inter alia: how income distribution affects poverty (Datt & Ravallion, 1992; Kakwani, 1993; Ali & Thorbecke, 2000) and; the importance of inequality in the response of poverty to growth (Ravallion, 1997; Easterly, 2000; Fosu, 2014). These studies range from African economies (Fosu, 2008, 2009, 2010a, 2010b) to a global sample of developing nations (Fosu, 2010c). The findings which are relevant to foreign aid policy makers are consistent with the need for policy to act more on inequality than on growth in the fight against poverty, inter alia: “*The study finds that the responsiveness of poverty to income is a decreasing function of inequality*” (Fosu, 2010b, p. 818); “*The responsiveness of poverty to income is a decreasing function of inequality, and the inequality elasticity of poverty is actually larger than the income elasticity of poverty*” (Fosu, 2010c, p. 1432); and “*In general, high initial levels of inequality limit the effectiveness of growth in reducing poverty while growing inequality increases poverty directly for a given level of growth*” (Fosu, 2011, p. 11).

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<sup>4</sup> Easterly (2008) has recently quoted from the Department for International Development (DFID): “*Aid works. Aid helps reduce poverty by increasing economic growth, improving governance and increasing access to public services..... But some parts of the international system have become either too complicated and inefficient or simply do not work at all. They must change*” (pp. 1-2).

<sup>5</sup> Growth could be accompanied by substantial negative externalities. Economic prosperity ameliorates possibilities of production and these possibilities do not necessarily imply equal benefits. Contrary to Kuznets (1955, 1971), the inverted-U relationship between inequality and growth is no longer considered as an unavoidable development path. Economic prosperity between 1990-2010 has been accompanied with substantial poverty and inequality, although some studies show that African nations have done relatively better in terms of poverty reduction (Young, 2012; Pinkivskiy & Sala-i-Martin, 2014) and inequality (Fosu, 2014). During the same time span, South East Asian and Latin American nations with substantial inequality and economic prosperity during the 1980-2000 time period have witnessed considerable mitigation of inequality associated with slow growth. Within the same horizon, the Organisation of Economic Co-operation and Development (OECD), South Asian and, Middle East & North America (MENA) countries have witnessed rising inequality.

If economic growth is equated to the process of industrialisation, then Piketty and Fosu converge in the perspective that one reason for which industrialisation increases poverty is inequality. Hence, foreign aid could act on inequality to improve the effect of industrialisation on poverty in order to facilitate post-2015 objectives of inclusive and sustainable development (Miller, 2014; Timmons et al., 2009; Ozgur et al., 2009; Bagnara, 2012; Monika & Bobbin, 2012).

The literature documents evidence of an aid Kuznets curve that limits the income effect of foreign aid in the long-term (Sobhee & Nath, 2007, p. 157)<sup>6</sup>. This could be construed as aid becoming neutral in the long-term. The long-run aggregate effects of aid could be more apparent when inequalities are dealt with (Tezanos et al., 2013, p. 153)<sup>7</sup>. Within the context of this essay, there are three main motivations for using inequality as a benchmark for foreign aid: provide incentives for recipient governments to reduce inequality and hence, improve governance; remain consistent with Piketty and; prepare for the post-2015 agenda of sustainable development. First, while foreign aid has been found to improve or worsen inequality and governance,<sup>8</sup> nations with the best governance standards do not necessarily display lower levels of inequality (Piketty, 2014). Hence, focusing more on inequality as a benchmark for aid is worthwhile. Second, the interest of a policy reversal in respect of Piketty and contrary to Kuznets has already been covered in the above paragraphs. Third, the post-2015 development agenda has substantially emphasised the need for inclusive and sustainable development (UN: United Nations, 2013).

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<sup>6</sup> *"The outcome supports an inverted-U relationship between foreign aid and per capita income in the way postulated by the conventional Kuznets curve. Our postulate is empirically tested using a panel of 29 developing countries across a time span of 27 years; and from which the hypothesis of an 'Aid-Kuznets' curve could not be rejected"* (p. 157).

<sup>7</sup> *"The estimation produces three main results: aid is effective, in aggregated terms, once we deal with the effect of income inequalities; the impact of concessional loans seems to be greater than the impact of grants; and, aid may be more effective in less corrupt countries"* (p. 153).

<sup>8</sup> The effect on income could depend on characteristics like tied aid (Chao et al., 2010, p. 454). The impact on governance is still hotly debated (Boone, 1996; Bayart, 1992; Klitgaard, 1991; Hodler, 2007; Svensson, 1999, 2005; Arvin et al., 2002; Arvin & Barillas, 2002; Asongu, 2012, 2013a; Asongu & Jellal, 2013). Effectiveness may also depend on sound appraisal of issues in technical and adaptive systems (Monika & Bobbin, 2012, p. 71).

In light of the above, the inequality benchmark has a plethora of effects, *inter alia*: mitigate poverty by means of the growth elasticity of poverty discussed above; address collateral effects of long-term population growth; provide incentives for recipient nations to adopt inclusive development policies; indirectly fight bad governance and; avoid the policy shortfalls of the Kuznets conjectures. These advantages are discussed in detail in Sections 2-3 below. By addressing the issues, the essay supports recent evidence on structural and institutional disparities between rich and poor countries in the era of globalisation; *inter alia*, differing needs (Lalountas et al., 2011; Asongu, 2014a) and; scale of preference in ‘economic rights’ versus ‘political rights’ (Anyanwu & Erhijakpor, 2014).

I do not remain theoretical by simply raising the issues and discussing their post-2015 relevance, but also suggest foreign aid policy instruments by which the plethora of objectives highlighted above can be achieved. These include the improvement of old instruments documented in the literature as well as suggestion of new ones<sup>9</sup>.

To the best of my knowledge, the positioning of the essay steers clear of past studies that have proposed measures for reinventing foreign aid. The narratives include: general doubts about foreign aid channels (Krause, 2013, p. 223; Banuri, 2013, p. 208; Wamboye et al., 2013, p. 155; Ghosh, 2013, p. 218; Titumir & Kamal, 2013, p. 172; Marglin, 2013, p. 149; Monni & Spaventa, 2013, p. 56); less neo-colonial influences of conditionality (Amin, 2014, p. 125; Ndlovu-Gatsheni, 2013, p. 331); more self-reliance (Kindiki, 2011, p. 26; Fofack, 2014) and; imperative for holistic processes that better incorporate the needs of poor countries (Obeng-Odoom, 2013, p. 151; Amin, 2014)<sup>10</sup>. Celebrated literatures like Collier’s (2007)

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<sup>9</sup> Please refer to Section 4.

<sup>10</sup> These studies sustain that, the focus should not be on what developed countries think is good for poor countries. According to the narrative, poor countries value development aspects like happiness more. This is broadly consistent with an evolving stream of the literature on happiness and well being in the economics of development assistance (Arvin & Lew, 2010ab, 2011, 2012ab).

Bottom Billion<sup>11</sup>, Moyo's (2009) Dead Aid<sup>12</sup> and Eubank's (2012)<sup>13</sup> Somaliland hypothesis have broadly discussed the inequality issues in foreign aid but failed to properly present concerns in line with evolving development paradigms.

In fact, the need for reinventing foreign aid has been expressed quantitatively and qualitatively in many circles<sup>14</sup>. Measures that have been implemented to reduce poverty include, inter alia: Sachs' end of poverty experiment<sup>15</sup>; the IMF and World Poverty Reduction Strategy (PRS)<sup>16</sup>; cost effective interventions (Banerjee & He, 2008)<sup>17</sup>; Randomised Control Trials (RCTs, Duflo & Kremer, 2008)<sup>18</sup>; need for rigorous evaluation (Pritchett, 2008)<sup>19</sup>; reforms based on intensification, amputation and policy changes (Pritchett & Woolcock,

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<sup>11</sup> Collier sustains that foreign aid should not be managed by Official Development Assistance (ODA) because poor countries receiving aid are fragile and characterised with weak governance, political instability & conflicts and uncondusive mechanisms of government with which to disburse aid effectively. According to the account, poor countries are engulfed in four principal traps: conflicts; dependency on natural resources that are mismanaged; small nations with weak governance and; landlockedness surrounded by bad neighbours. The book argues for less dependence on 'development portfolios' that are less optimal strategies in poverty alleviation for the bottom billion. The authors call for a shift that would not evaluate the effectiveness of development assistance on a given Donor Gross National Income threshold.

<sup>12</sup> Moyo's counter aid arguments are principally presented in three main strands. First, the book is a genuine complain on the manner in which African nations are being patronized by the West. Second, it presents specific mechanisms via which aid has been detrimental to Africa. Third, entrepreneurial alternatives are offered for the continent. Her positions are substantially backed by renowned works like Rajan & Subramanian (2008). The thesis of Moyo broadly sustains that development assistance has increase corruption, poverty and dependence in Africa.

<sup>13</sup> Eubank has used a Somaliland based hypothesis to assert less dependence on foreign aid in an effort to improve the positive nexus of taxation on political governance.

<sup>14</sup> According to the Easterly (2008), the UNDP sustains that if developed nations want to seriously mitigate inequality, tackle poverty and secure more prosperous livelihoods for their citizens, aid as a percentage of their national incomes should increase to 0.7% by 2015 from the approximately 0.5% national income in 2010.

<sup>15</sup> The Sachs' Millennium Development project on eradicating poverty was announced as failed in late 2013 (Milburn, 2013). Thus using foreign aid to fight poverty may not be as easy as Sachs had previously thought: "*I have gradually come to understand through my scientific research and on the ground advisory work the awesome power in our generation's hands to end the massive suffering of the extreme poor.....success in ending the poverty trap will be much easier than it Appears*" (Easterly, 2008 p. 5).

<sup>16</sup> The PRS requires substantial planning in order to reduce even the most sophisticated bureaucracies of government (Klugman, 2002).

<sup>17</sup> These foreign aid related cost-effective interventions include, inter alia: deworming supplements in diet like iodine, vitamin A & iron; urban water provision; vaccination; fertilizer subsidies; control of malaria via indoor spraying and; controlling the spread of HIV AIDS through education on condom use and treatment of Sexually Transmitted Diseases (STDs). Though they are improving living standards, they are not keys to development in respect of some utopian scheme (Easterly, 2008).

<sup>18</sup> Duflo & Kremer have argued that there is scope for expanding RCTs in the evaluation of development assistance interventions. Though RCTs are not applicable to all dimensions of development assistance and development, they are having a substantial contribution to economic development because they constitute a new scientific method into aid and prosperity that run counter to traditional pseudoscience, wishful thinking and conclusions based on political motivations which are predominant in economics.

<sup>19</sup> Pritchett has discussed why rigorous evaluation is quite rare in development assistance using a political economy perspective.

2008)<sup>20</sup>; Advanced Purchase Commitment (APC, Kremer, 2008)<sup>21</sup>; new global initiatives (Radelet & Levine, 2008)<sup>22</sup>; ‘aid vouchers’ to the poor in order to promote competition in effective service delivery among aid agencies (Easterly, 2002, 2008) and; more emphasis on ‘searching for solutions’ than ‘planning for solutions’ (Easterly, 2006). Unfortunately, to the best of our knowledge, we do not know of any paper in the literature that has tackled the concern of reinventing development assistance by contrasting Kuznets with Piketty<sup>23</sup>.

Before presenting the essay in elaborate detail, it is relevant to discuss the originality and value of the present exposition by also highlighting how it steers clear of existing literature on development models. This essay neither extends the Beijing Model (BM) nor the Washington Consensus (WC) because both have increased inequality (Easterly, 2000; Moyo, 2013)<sup>24</sup>. It is not a consensus between the BM and WC because the bulk of studies on

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<sup>20</sup> Three more failed solutions have been documented by Pritchett & Woolcock. These include: amputation (the notion of privatising even when there is first a genuine requirement for public service and market failure); intensification (keep reaping the same thing by trying harder) and; policy reform (which does not recognize that ‘policies’ are neither the most difficult thing to change nor very intensive in transaction). Eight different options are proposed in light of the three failures: contracting out; single-sector participatory; supplier autonomy; community-driven development; decentralisation to municipalities or localities; demand-side financing; decentralisation of provinces or states and; social funds. According to the author, unless alternatives are tried in diverse sectors in different countries, there are no empirical and theoretical foundations for postulating claims about what policy is right or wrong.

<sup>21</sup> Reinventing foreign aid by means of APC for vaccines against diseases (like Ebola) that can threaten global health provides incentives for medical research while at the same providing some guarantee that diseases like tuberculosis, malaria and AIDS would be substantially curtailed, if not cured. In the scheme, the guarantee for purchasing a certain quantity of drugs at a certain price provides some incentives for medical research.

<sup>22</sup> The novel initiatives discussed by Levine and Radelet include: the Global Alliance on Vaccines and Immunizations (GAVI); the United State’s Millennium Challenge Account (MCA) and; the Global Fund against AIDS, TB and Malaria (GFATM).

<sup>23</sup> Responses to Piketty’s work have revolved around commentaries and reviews on: data quality (Reynolds, 2014), facts cross-checking (Branko, 2014; Krusell & Smith, 2014); reviews (Allen, 2014; Homburg, 2014) and, alternative views of the problem of inequality (Stiglitz, 2014).

<sup>24</sup> Fofack (2014) has defined the Washington Consensus (WC) as liberalisation, privatisation, marketisation and government failures, whereas the Beijing Model (BM) is founded on prudence in privatisation & liberalisation and government regulation. Moyo (2013) has defined the BM as ‘*state capitalism, deemphasized democracy and priority in economic rights*’ and the WC as ‘*private capitalism, liberal democracy and priority in political rights*’. Moyo has further suggested that inequality in China has increased relative to that of the West in the past decades. Hence, she has, proposed the WC as a long-run sustainable model. But this proposition does not imply that inequality has decreased with the WC. Moreover, Piketty (2014) and Easterly (2000, p. 1) also suggest that the WC has increased inequality: “Easterly finds no evidence for structural adjustment having a direct effect on growth. The poor benefit less from output expansion in countries with many adjustment loans than they do in countries with few such loans. By the same token, the poor suffer less from an output contraction in countries with many adjustment loans than in countries with few. Why would this be?”(p.1)

building complementarities are before Piketty's (2014) celebrated literature<sup>25</sup>. It is neither a branch of post-WC paradigms like the New Structural Economics nor Liberal Institutional Pluralism. It does not also fit into a recent stream of multi-polar development strategies (Fosu, 2013a)<sup>26</sup> or a reconciliation of the WC and the BM (Asongu, 2014b). It is useful to all highlighted strands in responding to one of the most striking policy reversals of our time.

As highlighted, consistent with Moyo (2013) and Piketty (2014), the BM and WC have substantially increased inequality over the past decades. As far as we know, growth and not inequality is the central focus of post-WC paradigms like the New Structural Economics (NSE) and Liberal Institutional Pluralism (LIP). While the NES presented by Chang (2002), Lin & Monga (2011), Norman & Stiglitz (2012), Stiglitz & Lin (2013) and Stiglitz et al. (2013ab) has recognized both State and market setbacks and advocated for a synthesis between ideologies of structuralism and liberalism, inequality is not the central element of the paradigm shift. This is also the case with the LIP school which is focusing on among others: institutional conditions for economic prosperity and institutional diversity (North, 1990; Brett, 2009; Rodrik, 2008; Acemoglu et al., 2005).

Narrowing the originality of this essay down to a regional perspective, it is important to note that most regional/national models of development have been based on Kuznets'

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<sup>25</sup> Please see Asongu (2014b) and the stream of studies on the need for building complementarities between the WC and BM (Drogendijk & Blomkvist, 2013, p. 75; Ovadia, 2013, p. 23; Wissenbach, 2009, p. 662; Carmody & Owusu, 2007, p. 504; Gu, 2009, p. 570; Lin & Farrell, 2013, p. 85; Mohan & Tan-Mullins, 2009, p. 588; Kragelund, 2009, p. 644; Zhang et al., 2013, p. 96; Kamwanga & Koyi, 2009, p. 6; Osei & Mubiru, 2010, p. 1; Kolstad & Wiig, 2011, p. 31; Alden & Alves, 2008, p. 43; Schiere, 2010, p. 615; Mohan & Power, 2008, p. 23; Sanfilippo, 2010, p. 599).

<sup>26</sup> Motivated by information from the past (Fosu, 2010d), Fosu (2012, 2013a) has documented interesting strategies and lessons on achieving success in development. Such strategies are derived from: burgeoning Asian giants of India & China (Singh, 2013; Yao, 2013; Santos-Paulino, 2013); Sub-Saharan Africa (Fosu, 2013b; Subramanian, 2013; Naudé, 2013; Lundahl & Petersson, 2013; Robinson, 2013); East Asia & the Pacific (Thoburn, 2013; Jomo & Wee, 2013; Lee, 2013; Khan, 2013; Warr, 2013); the Middle East & North Africa (Nyarko, 2013; Looney, 2013; Drine, 2013; Balamoune-Lutz) and; Latin America & the Caribbean (Pozo et al., 2013; De Mello, 2013; Cardoso, 2013; Trejos, 2013; Solimano, 2013). These perspectives which embolden a series of multi-polar strategies of development, include inter alia: dynamic policies in Malaysia and Vietnam that are focused on orthodox-heterodox initiatives; the political economy of China that is motivated by 'disinterested government'; policies of diversification in Oman, the United Arab Emirates (UAE) and, Oman; WC based reforms in Ghana and China; strategies in the management of natural resources in the UAE, Bahrain, Oman & Botswana; approaches of diversity in India founded on political systems based on democracy and; development programs of the social sector in Costa Rica & Tunisia (Fosu, 2013a).

conjecture. With the example of Africa (Asongu, 2014b), they include, inter alia: the AAF-SAP (African Alternative Framework to Structural Adjustment Programme for Socioeconomic Recovery and Transformation) of 1989; the APPER (Africa's Priority for Economic Recovery) of 1986-1990; the African Charter Population Participation for Development of the 1990; the LPA (1980-2000) or Lagos Plan of Action; the NEPAD of 2001 (Bujra, 2004; Adedeji, 2002; OAU, 1980, 2001) and; more recently, the documented self-reliance for African development (Fofack, 2014, p. 13).

The rest of the essay is organised as follows. Section 2 discusses the issues motivating the essay<sup>27</sup>. We tackle how the issues raised are relevant to the survey essay in Section 3<sup>28</sup>. Section 4 provides new policy measures with which discussed objectives can be reached<sup>29</sup>. These include new instruments as well as the improvement of existing ones. We conclude with Section 5.

## **2. What is the issue? Why prioritise inequality?**

There is an abundant literature on the ineffectiveness of foreign aid on growth (Mosley et al. 1987; Doucougliagos & Paldam, 2008; Easterly et al., 2004). While various reasons have been advanced for this ineffectiveness<sup>30</sup>, this study is positioned on more focus on inequality relative to growth for reasons already covered above. Moreover, though development assistance has in most likelihood not succeeded in positively affecting economic

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<sup>27</sup> This section addresses the concerns of why inequality should be given more emphasis in foreign aid policy. These include, inter alia: dynamics of foreign aid, governance and inequality; the imperative for a policy reversal in light of Piketty and; the post-2015 agenda of inclusive and sustainable development as well as recent literature on the need for foreign aid in achieving the post-2015 transformation goals.

<sup>28</sup> This section has three main concerns: first, identifies the issues raised in the essay contest; then, contextualises them in terms of inclusive and sustainable development and; finally discusses how more emphasis on inequality relative to growth would lead to better prospects for inclusive and sustainable development.

<sup>29</sup> Using the relevant literature to back our arguments, we show that focusing more on inequality than on growth would lead to more inclusive and sustainable development by achieving a plethora of goals, inter alia: mitigate short-term poverty; address concerns of burgeoning population growth; train recipient governments in inclusive development; fight corruption and mismanagement and; avoid the shortfalls of celebrated Kuznets' conjectures.

<sup>30</sup> These include, inter alia: unproductive consumption from the government; the Dutch Disease and poor institutions (Knack, 2001; Remmer, 2004; Boone, 1996; Bräutigam & Knack, 2004; Rajan & Subramanian, 2008; Heckelman & Knack, 2008) and; vested interest, coupled with poor planning and implementation (Easterly, 2002; Gibson et al., 2005; Dollar & Svensson, 2000).

prosperity, aid is expected in principle to improve income distribution and hence, benefit the poor in the short to medium terms (Bjornskov, 2010, p. 115)<sup>31</sup>. The author sustains that surprisingly, very little research focus has been devoted to income distribution. Within the context of this essay, there are three main motivations for using inequality as a benchmark for foreign aid: provide incentives for governments to reduce inequality and hence, improve governance; remain consistent with Piketty and; prepare for the post-2015 agenda of sustainable development.

There is a substantial bulk of the literature consistent with the positive role of foreign aid in mitigating income inequality (Tezanos et al., 2013, p. 153). While another strand of the literature has also substantially documented the positive role of aid in skewing income distribution (Svensson, 1999; 2005; Calderon et al., 2006; Bayart, 1992; Klitgaard, 1991; Layton & Fuller, 2008; Boone, 1996; Hoodler, 2007; Chong et al., 2009, p.89; Herzer & Nunnenkamp, 2012)<sup>32</sup>, some authors think the unexpected nexus is due to tied aid (Chao et al., 2010, p. 454) or the absence of an aggregate effect is due to high inequality (Tezanos et al., 2013, p. 153). Even countries with high governance and democratisation are also associated with high inequality<sup>33</sup>.

Second, the interest of a policy reversal in respect of Piketty and contrary to Kuznets has already been covered in the introduction.

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<sup>31</sup> According to the narrative, the first goal of the United Nations' Millennium Development Goals is to mitigate extreme poverty in undeveloped countries. This is conceived as a call for greater equity within and between countries.

<sup>32</sup> Using income inequality appreciated by the Gini coefficient, Calderon et al. (2006) find no robust nexus between inequality and aid. Conversely, Layton & Fuller (2008) find aid to be positively linked to income inequality in Asian and Latin American countries. Boone (1996) shows theoretically that aid benefits the political elite most. This narrative on elite benefits is consistent with Hodler (2007), Klitgaard (1991), Svensson (1999, 2005), Bayart (1992), inter alia.

<sup>33</sup> Democratisation skews income distribution in poor societies (Chong, 2004). This is also true at the global level (Dreher & Gaston, 2008). While foreign aid has been found to worsen inequality (Herzer & Nunnenkamp, 2012) and governance (Arvin et al., 2002; Arvin & Barillas, 2002; Asongu, 2012, 2013a; Asongu & Jellal, 2013), nations with the best governance standards do not necessarily display lower levels of inequality (Piketty, 2014). Hence, focusing more on inequality as a benchmark for aid is worthwhile.

Third, the post-2015 development agenda has substantially emphasised the need for inclusive and sustainable development. In essence, poverty eradication and the transformation of economies by means of sustainable development are keys to post-2015 development agenda on priority transformations. These include inter alia: ‘leave no one behind’; ‘put sustainable development at the core’; ‘transform economies for jobs and inclusive growth’; ‘build peace and effective, open and accountable public institutions’ and; ‘forging a new global partnership’ (UN, 2013, pp. 7-13). There is also a growing body of literature substantiating the role of foreign aid in achieving these objectives (Miller, 2014; Timmons et al., 2009; Ozgur et al., 2009; Bagnara, 2012; Monika & Bobbin, 2012).

### **3. How is addressing the issue relevant to the Survey essay?**

This section has three main concerns: first, identifies the issues raised in the survey essay; then, contextualises them in terms of inclusive and sustainable development and; discusses how more emphasis on inequality than growth would lead to better prospects for inclusive and sustainable development. Accordingly, the issues identified in the first theme of the survey essay are broadly consistent with need for foreign aid to be reinvented as an instrument of sustainable human development. The United Nations’ five points provided in the preceding paragraph on inclusive and sustainable development are tackled by this essay for the most part. Hence, we show that this essay addresses the issues of inclusive and sustainable development. As we have emphasised in the motivation, focusing more on inequality than on growth should achieve at least five goals that are consistent with the post-2015 development agenda.

First, poverty can easily be mitigated because the inequality elasticity of poverty is higher than the income elasticity of poverty (Fosu, 2010c p. 1432; Fosu, 2011, p. 11). Hence, the responsiveness of poverty to income is a decreasing function of inequality (Fosu, 2010b,

p. 818). Therefore foreign aid policy should give more priority to inequality (Piketty, 2014) than to growth (Kuznets, 1955).

Second, by focusing on aid instruments that mitigate inequality, issues of long-term unemployment and burgeoning population growth would be tackled to an extent. There is growing evidence that these issues would only be tackled by public investment unless efforts at stimulating private investment are put into place (Asongu, 2013b). Since, the growth in population is predominantly traceable to the low-income strata (Pommeret & Smith, 2005), improving on skewed income distribution would provide more avenues of qualitative birth relative to quantitative (Rosenzweig, 1990; Hasan, 2010, p. 360)<sup>34</sup> and potentially stimulate ‘purchasing power’ needed to boost private investment. Decreasing inequality increases the propensity to consume which is one of the channels by which population growth can influence investment (Asongu, 2015; Sweezy, 1940)<sup>35</sup>.

Third, if nations with lower inequality rates are likely to receive more aid, two scenarios are possible. There is potential for the adoption of ex-ante and ex-post pro-poor policies. While the former would be formulated to mitigate inequality in the hope of qualifying for more aid, the latter entails the pro-poor use of disbursed aid resources. Such may not be achieved if more priority is placed on growth.

Fourth, more emphasis on inequality in relation to growth would indirectly improve governance. The intuition here is that, more ex-ante and ex-post equitable distribution of income can hardly be achieved without improvement of governance. Moreover, we have seen above that nations with better governance standards do not necessarily manifest lower levels

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<sup>34</sup> There is a wide consensus that, with growth in income levels, families are more likely to prefer quality to quantity in terms of children. In line with Hasan (2010), an improvement in per capita income in China has been accompanied with declining population growth “...as per capita income increases, families turn to prefer quality over quantity of children. The resultant increase in the cost of bearing and rearing children would induce smaller family size and lead to decline in fertility” (p. 360). Pommeret & Smith (2005) provide ‘productivity volatility’ as another elucidation for the negative correlation. According to the authors, as an economy develops, the growth rate is affected by productivity volatility through two main alterations: decisions to procure children and saving decisions.

<sup>35</sup> The other two ways by which population growth can influence investment include: (1) the means of labour supply and; (2) via its impact on the competition of aggregate demand from consumers.

of inequality (Chong, 2004; Dreher & Gaston, 2008). Hence, priority in inequality should indirectly improve governance and but necessarily the contrary. The recent Moyo (2013) and Eubank (2012) conjectures could provide further elucidation for this deduction in the long-run and short-term respectively<sup>36</sup>. This elucidation also confirms the long-standing debate that institutions and political rights are more endogenous to economic rights. It should be noted in order to clearly highlight the Kuznets versus Piketty conjectures because, *‘Output may be growing, and yet the mass of the people may be becoming poorer’* (Lewis, 1955)<sup>37</sup>. Another extension linked to globalisation is that, poor countries are more concerned with economic rights (e.g income inequality) at the early stages of industrialisation, which leads to demand for better political rights (e.g governance) at the later stages (Asongu, 2014a, p. 346; Lalountas et al., 2011, p. 645)<sup>38</sup>.

Fifth, the policy shortfalls of the Kuznets conjecture would be mitigated if government places more emphasis on inequality than on growth. This point has already been elaborately discussed in the introduction.

While the first-four points above broadly address the inclusive dimension of post-2015 development objectives earlier highlighted, the fifth point emphasises the need for

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<sup>36</sup> With respect to Moyo (2013), mitigation of income inequality would improve income in the poorer fraction of the population. Hence, leading to demand for better governance. The narrative sustains that only a burgeoning middle class can sustainably demand better governance (Asongu, 2014b, pp. 17-18). Indirectly from Eubank (2012, p. 465), inequality reduction could increase taxation for more political governance. Accordingly, though Eubank does not directly address the issue of inequality, increased income distribution efforts also mean better government management of potential income to be taxed.

<sup>37</sup> Economic rights here should not be equated to economic prosperity or growth. Improvement in income distribution accruing from economic prosperity is essential for any such equation. Hence, our interpretation of the debate steers clear from the positions of Asongu (2014, p. 1569) and Anyanwu & Erhijakpor (2014, p. 15).

<sup>38</sup> *“Thus, our main conclusion is that globalization could be a powerful means of fighting corruption, only for middle and high income countries. For low income countries however, globalization has no significant impact on corruption. We might therefore conclude that at low levels of per capita income emphasis is given to the economic dimension of international integration and as a result the effect of globalization on corruption is limited. Persistence on globalization as an effective means to reduce corruption in developing countries might lead to inappropriate policies. On the contrary, at high levels of per capita income emphasis is given to the political and social dimensions of globalization and as a result the effects of this phenomenon on corruption control are significant”* (Lalountas et al., 2011, p.645). The Lalountas et al. (2011) hypotheses have been confirmed in Africa using different income thresholds and methodological specifications (Asongu, 2014a, p. 346).

sustainability in the use of foreign aid for inclusive development. For more subtlety, we also propose foreign aid instruments for inequality mitigation.

#### **4. Foreign aid instruments for inequality mitigation**

##### **4.1 Informality and Knowledge economy instruments for inclusive and sustainable development**

Knowledge economy (KE) is an essential tool for inequality mitigation (Lustig, 2011). There are also growing connections among, globalisation, KE, poverty mitigation and informality that merit great emphasis. First, globalisation has substantially increased informalisation to the detriment of formalisation (Asongu, 2014d). Second, KE is relatively more positively associated with the informal than with the formal economic sector of poor countries (Asongu, 2014ef), especially mobile telephony (Asongu, 2013c). Third, KE is good for the poor because it substantially mitigates inequality (Asongu, 2014g), especially mobile telephony (Asongu, 2014h). The above narratives imply that globalisation has fuelled informality and KE, which are good for the poor. The role of informality in mitigating income inequality is interestingly presented by Asongu (2013d, p. 401) who has investigated how reforms affect inequality through various formal, non-formal and informal channels<sup>39</sup>. Mobile telephony is also substantially pro-poor (Asongu, 2013e)<sup>40</sup>. These represent the inclusive dimension of the essay.

On the sustainable front, competition in the era of globalisation is essentially centred on KE, which has prominently featured in the reports of leading international organisations

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<sup>39</sup> “Hitherto, unexplored financial sector concepts of formalization, semi-formalization and informalization are introduced. Four main findings are established: (1) while formal financial development decreases inequality, financial sector formalization increases it; (2) whereas semi-formal financial development increases inequality, the effect of financial semi-formalization is unclear; (3) both informal financial development and financial informalization have an income equalizing effect and; (4) non-formal financial development is pro-poor. Policy implications are discussed” (p. 401).

<sup>40</sup> The narratives address the concerns earlier raised by Mpogole et al. (2008, p.71) on the need for more research on the connection between mobile technology and development. More recent examples include, inter alia: mobile phones improving access to health services by the poor (Kliner et al., 2013) and; ‘We conclude that mobile phone-based money transfer services in rural areas help to resolve a market failure that farmers face; access to financial services’ (Kirui et al., 2013, p. 141).

since the year 2000, inter alia: the World Bank and the Organisation of Economic Co-operation and Development (OECD). Hence, KE is has become an ineluctable phenomenon which can be neglected only by putting into jeopardy the prosperity of less developed countries (Dahlman, 2007; Chandra & Yokoyama, 2011; Tchamyou, 2014). It should be noted that South Korea which has relatively low inequality today (Kim, 2012) was on the same development threshold as most African countries in the 1960s (Tran, 2011)<sup>41</sup>. As a KE<sup>42</sup> and development model for Africa today (Asongu, 2014i), her economy was foreign aid driven. In some decades she received almost the same amount of development assistance as the entire African continent from some Donors<sup>43</sup>.

Overall, we have observed that: (1) foreign aid targeting informality would better mitigate poverty & inequality and; (2) aid targeting the improvement of KE for inclusive development would be more useful if channelled via the informal sector. These instruments could substantially curtail the bureaucracy associated with formality in aid disbursements.

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<sup>41</sup> “After the Korean war, South Korea was one of the world's poorest countries with only \$64 per capita income. Economically, in the 1960s it lagged behind the Democratic Republic of the Congo (DRC) – currently holding [elections marred by violence](#). Since then the country's fortunes have diverged spectacularly. South Korea now belongs to the rich man's club, the OECD development assistance committee (DAC). The DRC has gone backwards since independence and, out of 187 countries, ranked bottom in the 2011 [Human Development Index](#)” (Tran, 2011).

<sup>42</sup> Whereas the development strategy which emphasised KE as a development model was not clearly articulated during South Korean's economic miracle, it is very clear today that the nation's progress was fundamentally based on components of the World Bank's knowledge economy index (KEI), notably: education, ICT, economic incentives & institutional regime and innovation (Suh & Chen, 2007). According to the narrative, the model of development involved, amongst others: the development of human resources consolidated with intensive learning processes and building of technological capacity, fostering transformations and government display of proactive leadership and; promotion of industries that could handle import- and/or export-substitution, depending on economic objectives.

<sup>43</sup> In presenting Korea as a development model, Tran (2011) has emphasised that the country benefited from mass injections of development assistance from the Japan and the USA. For instance, the narrative sustains that the USA offered Korea 60 billion USD loans and grants between 1946 and 1978. Within the same spell of time, the corresponding USA development assistance to the entire African continent stood in the neighbourhood of 68.9 billion USD. Therefore, if African aid were to be shared proportionately among countries, it would be logical to infer, that holding other things constant, South Korea's substantial progress was somehow aid-driven. This inference is even more valid because of similar initial conditions, to assert the least: most African nations were more developed than South Korea in the 1960s (Tran, 2011).

## 4.2 KE and informality targeting gender equality

The two instruments of KE and informality in Section 4.1 would be more effective if women are prioritised. Hence, the policy of gender equality in the instruments would substantially mitigate poverty and inequality. Due to space constraint, we discuss three main channels related to the association of women with informality in developing countries, notably: mobile banking and financial inclusion, household management and empowerment for small businesses.

First, on ‘mobile phone and financial inclusion’ it is obvious today that financial access by means of phone-based transfer has substantially mitigated poverty among the marginalised fraction of society, most of whom are women (Jonathan & Camilo, 2008; Asongu, 2014h; Demombynes & Thegeya, 2012; Ondiege, 2010, 2013)<sup>44</sup>. More specific instruments/case studies by which such financial inclusion could be attained, include inter alia: ‘*banking on including women*’ (Koning, 2013); ‘*adjustment of framework conditions by regulators and policy makers*’ (Frickeinstein, 2013); ‘*going beyond expectations to gender analysis*’ (Ghosh & Berfond, 2013); ‘*measuring gender performance in micro finance*’ (Iskenderian, 2013). Foreign aid could play a substantial role in materializing these instruments. The Department for International Development (DFID, 2013) has already provided an interesting toolkit for promoting the financial inclusion of women.

Second, KE by means of mobile telephone could substantially assist women in the management of household budgets when they are confronted with poverty-related negative shocks that are unpredictable. The measures include inter alia: timely responses, better

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<sup>44</sup> According to the narratives, the substantial level of mobile phone penetration is providing pocket-banks to previously unbanked people around the world. Hence, it is providing cost-effective and affordable mechanisms by which the population that has been excluded for decades from formal financial services can be brought on board. Most of whom are women (Asongu, 2014h).

financial management and, more insights into how to cope with such vulnerable shocks (Al Surikhi, 2012; Asongu, 2014h)<sup>45</sup>.

Third, women could be empowered to engage in small businesses by means of mobile telephony or run existing structures in an efficient manner. This economic empowerment could substantially contribute to bridging the gender income gap and knowledge economy, that has been found to favor the starting and doing of business (Tchamyu, 2014)<sup>46</sup>.

The use of foreign aid in the above is sustainable in the perspective that it would help in avoiding the situation Japan is facing today. Accordingly, the country has just realised women are *'the economic saviours of Japan'* and hence, fully integrating women into the workforce would substantially boost GDP and at the same time fight the concern of an ageing population (Chen, 2014). In substance *'valuing women's knowledge and experience creates opportunities for the whole community'* (IFAD, 2014, p. 7)<sup>47</sup>.

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<sup>45</sup> Consistent with Asongu (2014h), the probability for the 'financially unfavored' to incur a substantial loss because of some unpredictable negative shock is most probably assuaged and mitigated when families respond to them timely. In this regard, the mobile technology drives down the cost linked with such a shock. More optimal financial managing and shock mitigation include: more efficient actions, lower cost of traveling, improved access to information and, less trauma. For instance, in situations of vulnerability like family illness or death, cost mitigation and income saving by means of mobile telephony are crucial. A security improvement for very poor families via lower cost is an advantage. For example, the ability of a family to drive-down the overnight hospital number of days or capacity to mitigate cost of transport during times of desperation are among substantial cost savings measures implemented with the help of a quick mobile phone dial. In summary, the device of communication provides some margin of tolerance for response, multi-task, reduced surprise and time needed to search for stakeholders during crisis.

<sup>46</sup> General trainings (Singh et al., 2011, p. 202) especially on entrepreneurial intentions (Gerba, 2012, p. 258) and financial literacy (Oseifuah, 2010, p. 164) could have a long-term positive effect on poverty mitigation (Mensah & Benedict, 2010, p. 138). These trainings also have the potential for substantial positive externalities with successful stories (Wantchekon et al., 2014).

<sup>47</sup> The IFAD has learnt the following on mobilizing the 'gender advantage', inter alia: *'Building on women's knowledge and experience creates opportunities for the whole community'*; *'Promoting equitable access to adaptation knowledge for women and men is a key practical step for inclusive adaptation'*; *'Investing in women brings economic returns for smallholder farmers'*; *'Supporting women's equal voice in decision-making about adaptation strategies is needed in the home, in the community and at the national and global levels'*; *'It is important to tackle women's workloads, which are often greater than that of men's and tend to increase as a result of climate change'* (p. 6). These lessons have been drawn from a plethora of case studies, among others: *'Mali: Unlocking the capacities of different generations'* (p. 8); *'Nigeria: Dedicated support for women and young people'* (p.11); *'Peru: Reduced workloads and transformed gender roles'* (p. 18); *'Mauritania: Men and women working together'* (p. 10); *'Kyrgyzstan: Alternative income sources'* (p.12); *'Bangladesh: Early warning systems'* (p.9); *'China: Access to clean energy'* (p. 17); *'Swaziland: Women, unity and water'* (p.13); *'India: Women's self-help groups heard at climate policy forum'* (p.15) and; *'Bolivia: Building on indigenous women's knowledge'* (p. 7).

### 4.3 Inequality as the primary benchmark and improving of existing instruments

We have already substantially covered why inequality (as opposed to growth) is more effective in poverty mitigation. We have also covered why focusing on governance and democracy has not produced the desired outcome. Hence, aid could be considered as a kind of foreign direct investment (FDI) with income-inequality in the recipient countries being a primary determinant. This could provide incentives for recipient countries to work towards improving what we coin as the '*foreign aid attraction climate of inequality*'. As we have discussed earlier, improvement of income-distribution in anticipation of attracting more foreign aid would predispose improvement of governance<sup>48</sup>. Hence, two birds are shut here with one stone. The information criteria for this purpose could include inclusive development instruments like, amongst others: GINI coefficient, inclusive growth index, inequality adjustment economic growth and, inequality adjusted human development index (IHDI).

We also suggest how some existing instruments could be improved to achieve discussed goals:

-aid conditionalities could be shifted to inequality from mainstream criteria (human rights, governance, income levels, landlockedness), because addressing the issue of inequality indirectly tackles some of the concerns in the criteria;

-given the complex and multidimensional feature of foreign aid, 'searching for inequality conditionalities' that work should be preferred to 'planning for inequality conditionalities that would work'<sup>49</sup>;

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<sup>48</sup> Taking the example of mobile phone penetration, the quality of institutions matters for its enhancement of income equality (Asongu, 2013e, p. 56 ).

<sup>49</sup> "*This is bad news for the world's poor, as historically poverty has not been ended by central planners. It is ended by "searchers," both economic and political, who explore solutions by trial and error, have a way to get feedback on the ones that work, and then expand the ones that work, all of this in an unplanned, spontaneous way. Examples of searchers are firms in private markets and democratically accountable politicians*". (Easterly, 2008 p. 6). Also see Whittle & Kuraishi (2008).

-the employment of ‘aid tournaments’ based on inequality should motivate recipient governments to act, since budgets for aid would be allocated for a pool of nations and later effectively disbursed based on best-performing nations in equality terms;

-publishing aid disbursements alongside corresponding inequality criteria upon which the selection is based should be mandatory for mutual monitoring and transparency.

#### **4.4 Reversal of policy instruments in theoretical underpinnings**

The theoretical underpinnings of catch-up literature clearly sustain that foreign aid was economically designed to boost growth in order to reduce the wealth gap between rich and poor countries. These are clearly articulated in the Harrod-Domar, Solow-Swan theoretical predictions of neoclassical growth models (Easterly, 1999, 2005ab). At the national level, the role of foreign aid as an instrument of boosting growth for ‘inequality mitigation’ has to change. In fact, a rethinking of policy is required. In simply investing or providing foreign aid with the hope that inequality would be adjusted automatically in the long-run, policy makers will be getting the Piketty badly wrong.

### **5. Conclusion**

In spite of a recent survey of the literature concluding that 40 years of foreign aid has not been effective (Doucouliagos & Paldam, 2009) and more recent provocative titles like ‘foreign aid follies’ which sustain that foreign aid has never developed anything (Rogoff, 2014), the phenomenon of development assistance is like a ‘policy’ which should not be systematically reduced to ‘bad or good’. The challenging policy syndrome<sup>50</sup> today is a paradigm shift that requires effective mechanisms with which to prepare developing nations

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<sup>50</sup> Fosu (2013c) has defined ‘policy syndromes’ as situations that have not been favourable to economic prosperity, inter alia: ‘state controls’, ‘state breakdown’, ‘administered redistribution’, and ‘suboptimal inter temporal resource allocation’.

for industrialisation in the perspective of Piketty since the celebrated Kuznets conjecture on which some of the fundamentals of foreign aid are based is no longer relevant in our time.

This survey essay has neither extended the Beijing Model nor the Washington Consensus (WC). It is neither a branch of post-WC paradigms like the New Structural Economics nor Liberal Institutional Pluralism. It does not also fit into a recent stream of multi-polar development strategies. It is useful to all highlighted strands in responding to one of the most striking policy reversals of our time. It argues that in order to achieve sustainable and inclusive development, foreign aid should not orient developing countries towards industrialisation in the perspective of Kuznets but in the view of Piketty. Abandoning the former's view that inequality will fall with progress in industrialisation and placing more emphasis on inequality in foreign aid policy will lead to more sustainable development outcomes. Inter alia: mitigate short-term poverty; address concerns of burgeoning population growth; train recipient governments on inclusive development; fight corruption and mismanagement and; avoid the shortfalls of celebrated Kuznets' conjectures. We discuss how the essay addresses post-2015 development challenges and provide foreign aid policy instruments with which discussed objectives can be achieved. In summary, the essay has reviewed over 200 papers and provides useful policy measures to avoid past pitfalls. *'Output may be growing, and yet the mass of the people may be becoming poorer'* (Lewis, 1955). *'Lewis led all developing countries to water, proverbially speaking, some African countries have so far chosen not to drink'* (Amavilah, 2014). Piketty (2014) has led all developing countries to the stream again and a challenging policy syndrome of our time is how foreign aid can help them to drink.

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