Is comparative advantage in aid a good idea?

By Terence Wood
2 June 2011

As a Kiwi I am honour-bound never to admit to envy of Australia. And yet, over the past year, it's been hard not to feel just a bit envious of your aid programme. While New Zealand ODA continues to struggle through haphazard political decisions, AusAID is the focus of a serious review and considered engagement from politicians.

Andrew Leigh's speech to the Lowy Institute (reposted on his website) is a case in point. Leigh clearly not only cares about development outcomes, but he's also aware of the fact that aid is difficult, and that evidence matters. Good aid is cautious and involves ongoing systematic learning. Which might seem obvious, but too often this hasn't been the case in the past. Ideology and certainty have persistently hampered aid efforts. For this reason, engagement from people such as Dr Leigh has got to be good for Australian aid.

Given all this, it feels churlish to disagree with Dr Leigh. But, the more I think about it, the more one aspect of his Lowy Speech seems mistaken to me. This is his call for Australia to focus its aid on areas where it has 'comparative advantage'.

The comes from trade theory and, broadly put, is the idea that individuals, states and firms, should focus on what they do best and trade to obtain other items. Leigh uses it in his speech to suggest that Australian aid should either focus on things that the aid programme already does well (his example is work in post conflict societies) or in areas where Australia as a country has particular experience (as examples he gives dry-land agriculture and managing mineral wealth).

At a first glance the argument appeals — why not focus where you think your agency or country has skills? — but it has three major flaws. The first two to do with context, the third with politics.

Context, above all else, ought to guide aid work. The constraints faced by different developing countries vary. Potential solutions vary too – even where the technical problem is similar, domestic political economy and community norms may require different approaches. And as external agents of change, aid agencies inevitably face additional hurdles, needing to work through interlocutors and with limited information. Given this, to be effective, aid needs to focus first and foremost on what's needed and on what may realistically be achieved in the particular country or region it is being given. Anything else is a distraction.

And this is the first problem with the concept of aid agency comparative advantage: if you let yourself get caught up in thinking about what your country is naturally good at, you're distracting yourself from what really matters. There's a risk that, like the proverbial hammer, everywhere you look you'll start to see nails.

The next problem is that, institutionally and socially, developing countries are distinctly different from their developed world counterparts, so even when their problems appear familiar, it doesn't follow that developed country experience will necessarily have much to offer by the way of solutions. Take for example the case of mineral wealth, mentioned by Leigh. It's one thing to set up a mechanism for managing this in a way that maximises social benefits in Australia. But it's probably going to be another thing altogether in Papua New Guinea, where the political economy is different, the reach of the state less, the importance of informal institutions far greater, and relevant property rights less clearly delineated.

The third problem with focusing aid on donor countries' comparative advantages is a political one. Once you start to pump a lot of aid through firms and similar entities in your own country (for example in this case, Australian agricultural institutes) you create a domestic lobby, with the risk that this lobby, through its advocacy and influence, may start shaping aid policy in a way that is of primarily benefit to itself. This may sound far-fetched but it is exactly what has happened with US food aid, where the benefits to US farmers from the government buying their surplus crops to distribute as aid are so significant that the farmers have lobbied successfully to keep the programme, despite it being shown to actually be harmful in some ways to recipient countries. 'Boomerang Aid' – aid where the primary benefits accrue to donor countries, has been a perennial problem in development, for obvious reasons. Recipients of aid in developing countries have no political clout in donor countries, yet domestic interest groups do. Which means its often much easier for such interest groups to influence aid decisions than it is for the people who really matter. Best, I think, not to inadvertently aid in creating such a problem by getting caught up in thoughts of comparative advantage.

Fortunately, there is another way of giving aid — and an alternative to comparative advantage — which will help maximise the benefits of scarce aid resources. And it’s an approach that that will make sense to an economist au fait with trade theory. This is simply: find out what is needed, and what aid can realistically achieve, and then source the solution from wherever in the world it can be obtained reliably at the best price. Do this, and use the tools of evidence gathering that Dr Leigh rightfully supports, and you’ve maximised the chance of your aid helping the poor.

About the author/s

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