

# Should aid focus on economic development?

By Terence Wood

In 2009 the New Zealand government changed the mandate of its aid programme, giving it a core focus on economic development. The move put the New Zealand aid programme in good company: JICA, the World Bank and the DANIDA all refer to economic development in their mandates, while AusAID and USAID afford it prominence.

And yet in parts of the New Zealand development community the change in mandate was seen as major mistake.

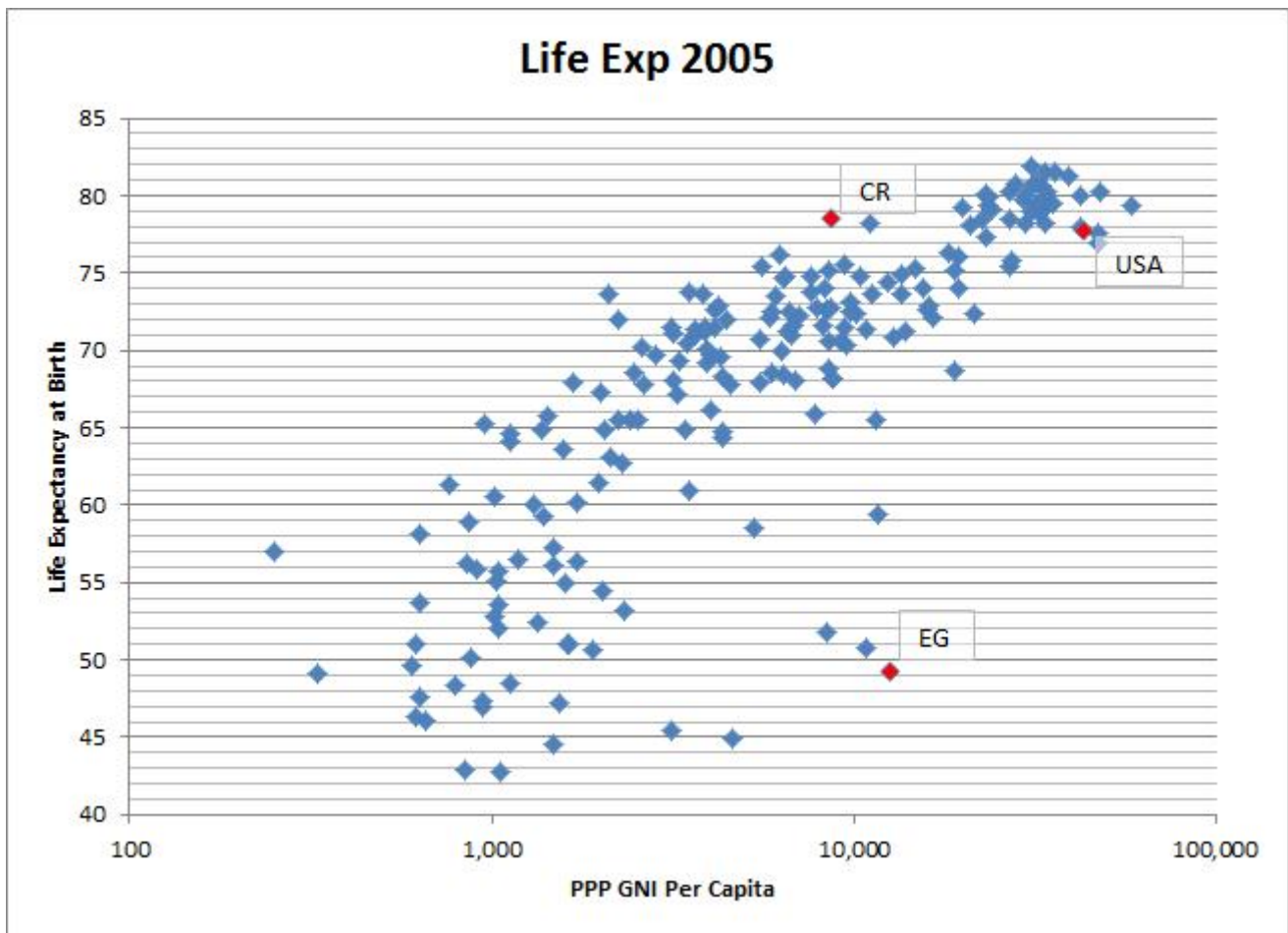
Was the change a positive one for the New Zealand aid programme? And, more generally, should aid agencies focus on economic development? In my next two blog posts I will try and answer these questions. I'll do this in two parts. GDP/capita is hardly an end of its own, so today I'll investigate whether economic development brings benefits in areas that really matter, focusing on health and poverty.

Then next week I'll examine whether aid is an effective tool for bringing about economic development. I'll do this is because, even if economic development is a worthwhile objective, there's still not much point focusing aid on it unless aid actually brings it about.

### **Economic Development and Health**

As a sufferer of a chronic illness I can say from experience that good health is an important element of a meaningful and happy life (my beliefs here are confirmed by survey evidence showing health to be a central aspect of reported life satisfaction). So if economic development can be shown to bring good health, this would be a significant mark in its favour.

In the chart below I've plotted (using 2005 data from the World Bank [World Development Indicators](#)) PPP adjusted GNI per capita (an indicator of level of economic development — on a log scale on the X axis) and life expectancy at birth (a proxy for health outcomes more generally — on the Y axis). Each dot on the chart represents a country.



Visible in the graph is a strong association between economic development and life expectancy. This association itself isn't proof that higher GNI causes higher life expectancy (the causal link may, and indeed probably does, in part run in the opposite direction) but the general consensus among development economists is that economic development does lead to better health. Or as Spence and Lewis put it [[pdf](#)]: ““We can say with confidence that economic growth improves health.”

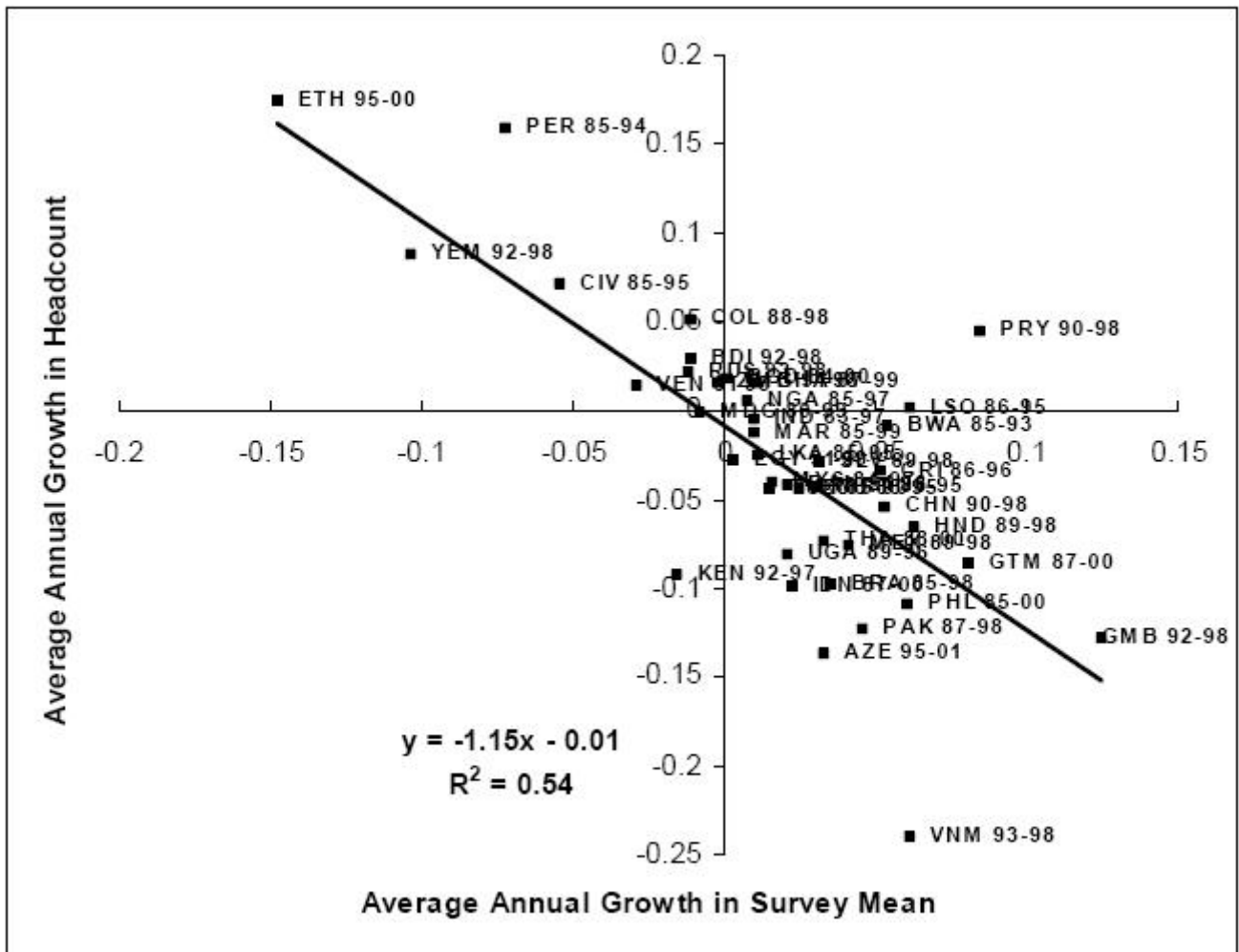
The relationship becomes weaker as countries become wealthier (remember the X axis is log scale). Also there's a lot of variance around the line - as is illustrated by the countries in red. Equatorial Guinea (EG) is wealthier than Costa Rica (CR) yet its life expectancy is 30 years lower. Likewise, the USA is substantially wealthier

than Costa Rica, yet its life expectancy is actually slightly lower too. Wealth may lead to health on average but there is a lot of space around that average. Which means that, up to a point, there is a lot that can be done to improve health even in countries with low levels of economic development.

### **Economic Development and Poverty**

Very few people would argue that development work shouldn't ultimately aim to reduce poverty. Not only is poverty associated worse welfare but living in poverty dramatically reduces opportunity too.

The chart below comes from the Art Kraay paper, ['When is Growth Pro-Poor?'](#) Each point on the chart represents a country (over a particular period of years), the X axis shows the country's rate of economic growth and the Y axis shows the change in poverty levels for the country.



The pattern is clear enough. Higher rates of growth are generally associated with more rapid poverty reduction. As with health, the impact of economic development on poverty is relatively uncontroversial amongst development economists. On average, economic development leads to poverty reduction. There is variance around this average: growth can be more or less pro-poor (and in some, relatively rare, instances can be actively anti-poor), meaning that anyone concerned about poverty needs to also be concerned about inequality too. But, on average, economic development does appear to be a good tool for poverty reduction.

## Other Areas

The relationship between economic development and other aspects of development varies. The best available evidence suggests that - subject to diminishing returns - economic development is associated with increased happiness and life satisfaction (which surely ought to be our ultimate yardstick of development), but in other areas, such as the relationship between economic development and those MDG Indicators not associated with health and poverty, the [one study that I am aware of \[pdf\]](#) purports to have found the relationship to be weak.

## What Does This All Mean?

Although it's not everything, in the case of poverty, health and happiness, economic development really does, on average, lead to meaningful improvements in people's lives. Which means that, *if aid can be shown to be an effective tool in promoting economic development*, a focus on it would seem justified. Yet at the same time, as the experience of countries like Costa Rica show, relatively low economic development can still be translated into worthwhile improvement. Also, the variance around overall averages means that an excessive focus on economic development, with no attention to distribution might not be a particularly effective tool for promoting development at all.

Next week I'll look at the relationship between aid and economic development.

[Update: you can now read the second part of my attempt to answer the aid and economic development question [here](#).]

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## **About the author/s**

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