

This is the time for giving

“Then the Grinch thought of something he hadn't before! What if Christmas, he thought, doesn't come from a store. What if Christmas...perhaps...means a little bit more!”

— Dr. Seuss, *How the Grinch Stole Christmas!*

Just as Christmas is the time for sharing and generosity, perhaps January ought to be the time for thinking about whether all that generosity does any good in the world. After all, the idea of charity is not to give, but for somebody to receive.

Though charities come in many different varieties, perhaps the most ambitious is foreign aid. Whereas personally helping those physically close to us can be difficult, ensuring that our help actually improves the lives of those much poorer than us thousands of miles away is a daunting task. Therefore, perhaps not surprisingly, in spite of more than 4 trillion dollars spent on foreign aid over the past half a century (by OECD estimates) it is difficult to show any positive correlation between aid and economic development (Burnside and Dollar, 2000; Easterly, 2003). A part of the problem is the identification problem that plagues all of cross-country comparisons: No two countries are exactly alike and a myriad of factors are changing over the horizons usually considered. But, nevertheless, it is true that many of the biggest recipients of foreign aid continue to linger in poverty (Afghanistan, Ethiopia, The Democratic Republic of Congo etc.).

So why does foreign aid seem to work so poorly? Economists see this as a principal-agent problem: Regardless of what products or services (charity or otherwise) we spend our money on, we (the principals) want to make sure that the providers of these services (the agents) act in accordance with our wishes. This is typically easy when buying consumer goods. If you don't like the specifications of a computer, you can choose not to buy it; if you don't like your local grocery store you can go elsewhere. This creates a strong feedback effect and gives the computer producers a strong incentive to produce a computer you would be happy with. This is the case with most things we spend our money on, exactly because it is the same person who enjoys the product and spends the money. Things are different with charities. We as donors have little sense of where and on what our money is spent and even more importantly, the recipients of that aid have little ability to decide what type of aid they want to receive because they aren't paying the bill. If an aid agency wants to build a well in a village, the villagers can't very well ask for a road instead or to get the money paid directly.

But surely the development experts mean well and know what they are doing, you say? Why would they go live in Sub-Saharan Africa if they didn't have the best of intentions in mind? Perhaps, but this is not necessarily enough.

First, development agencies have to operate under local political conditions, which can impose costs to local bureaucracy and bribes to the local authorities diverting the funds for their own ends (Reportedly, millions of the money raised from the Live-Aid concerts of 1985 were siphoned off for arms purchases in Ethiopia). In fact, there is some suggestive evidence that development aid is effective when recipient countries are well run (Burnside and Dollar, 2000).

Second, many of these well-intentioned development experts are quite well paid either abroad or at home. Administrative costs vary from a few percent to more than 50 per cent of donations. Though, one should be careful judging a charity based on administrative costs, certainly 50 per cent is too high.

Third, and perhaps most centrally, many development agencies take a top-down approach to development planning. Though an appealing thought, if anything the failure of socialism taught us that human societies are simply too complicated to be centrally managed. And even more so by foreigners who are unaware of the local conditions. The history of development is littered with stories of schools falling out of use shortly after being built, factories that never opened, and harvests rotting away without being able to reach the market, all because development experts had missed a crucial missing factor.

So, what should we do? Stop giving to charities? No, not at all, but we should pay much more attention to where our money goes. One way of doing that is by helping directly. Unfortunately, that might be rather inefficient (I am an economics professor and few poor people have any direct need for lessons in economics) and it is difficult to personally help people far away who are usually the people who need it the most.

Alternatively, you can demand that your charity is able to scientifically demonstrate the impact your donation makes, just as pharmaceutical companies have to demonstrate the efficacy of their products. This very idea has taken central stage in development economics over the past couple of decades. As a result we have seen an explosion in the use of ‘randomized controlled experiments’, where akin to medical experiments a treatment group – say every child in a randomly selected group of villages is given anti-worm treatment – is compared to a control group – the children of villages that did not get the treatment –and the effect is the difference in outcome in school attendance, attendance, sick days etc. for the two sets of villages. While far from perfect, at least there is an attempt in demonstrating the effect of the aid.

www.Givewell.org is an example of an organization that requests such experimental data from charity organizations and uses it to recommend the most effective charities amongst thousands. Besides a number of more traditional charities (such as The Against Malaria Foundation, which have demonstrated high efficacy in preventing the spread of malaria), they recommend www.givedirectly.org, which takes a highly unorthodox approach to development: Instead of well-meaning, well-educated experts deciding how to spend the money, they simply pass donations of between 500 to 1500 dollars on to people who meet certain requirements of poverty, no questions asked. Perhaps contrary to expectations research has since confirmed that people who receive this money spend most of it on durable goods such as a metal roofs, they spend *less* on alcohol and tobacco and even manage to increase their future income by buying livestock and fertilizer.

And perhaps that is the biggest lesson. What better way of making charity less about us and more about the recipients than giving them full autonomy of how to spend the money. After all, who better knows what the poor need than the poor?

References,

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