

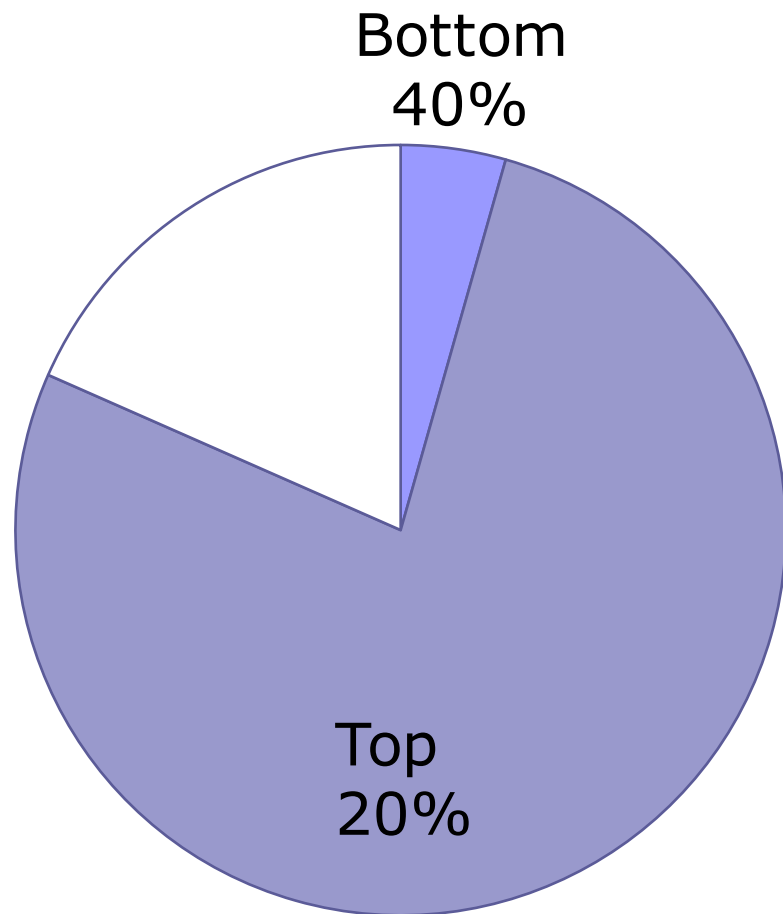
Foreign Aid

Rajeev Dehejia

Today

- The modern Samaritan's paradox.
- What is foreign aid?
- A short history of US foreign aid.
- Aid and growth: evidence.
- Implications.

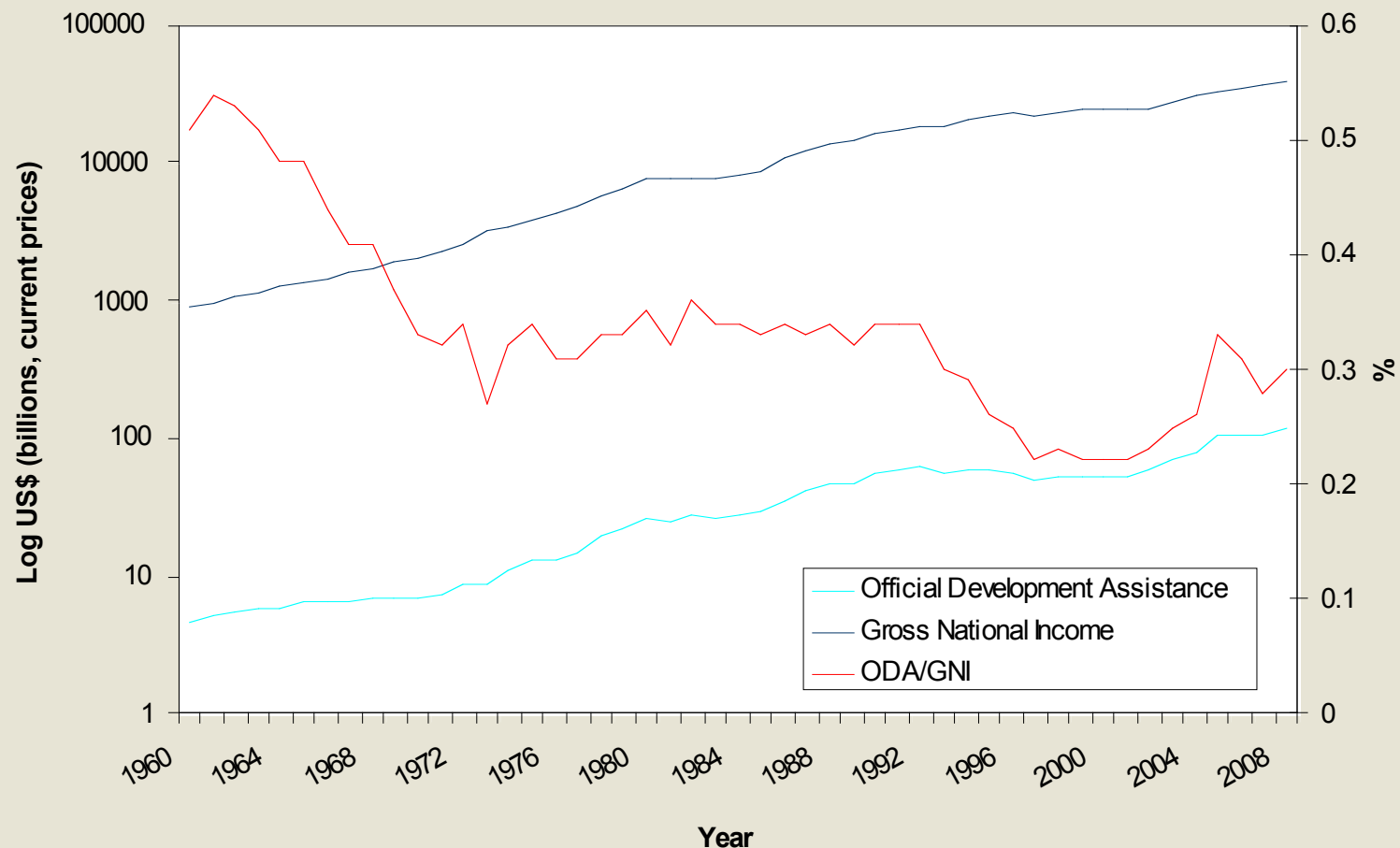
The Modern Samaritan's Paradox



Never in history have the world's rich been positioned to do so much for the world's poor.

But, the foreign aid paradox

Aid Disbursements and Income for OECD DAC Countries, 1960-2008



Foreign Aid

- What is foreign aid?
 - Transfer of money (capital) from one country to another (usually rich to poor).
 - Trade (access, subsidized)
 - Knowledge (technology transfer)
- Why do we have foreign aid?
 - Moral/ethical obligations.
 - Strategic (self) benefits.
 - Augment domestic savings and growth.
- Does it achieve its goals?

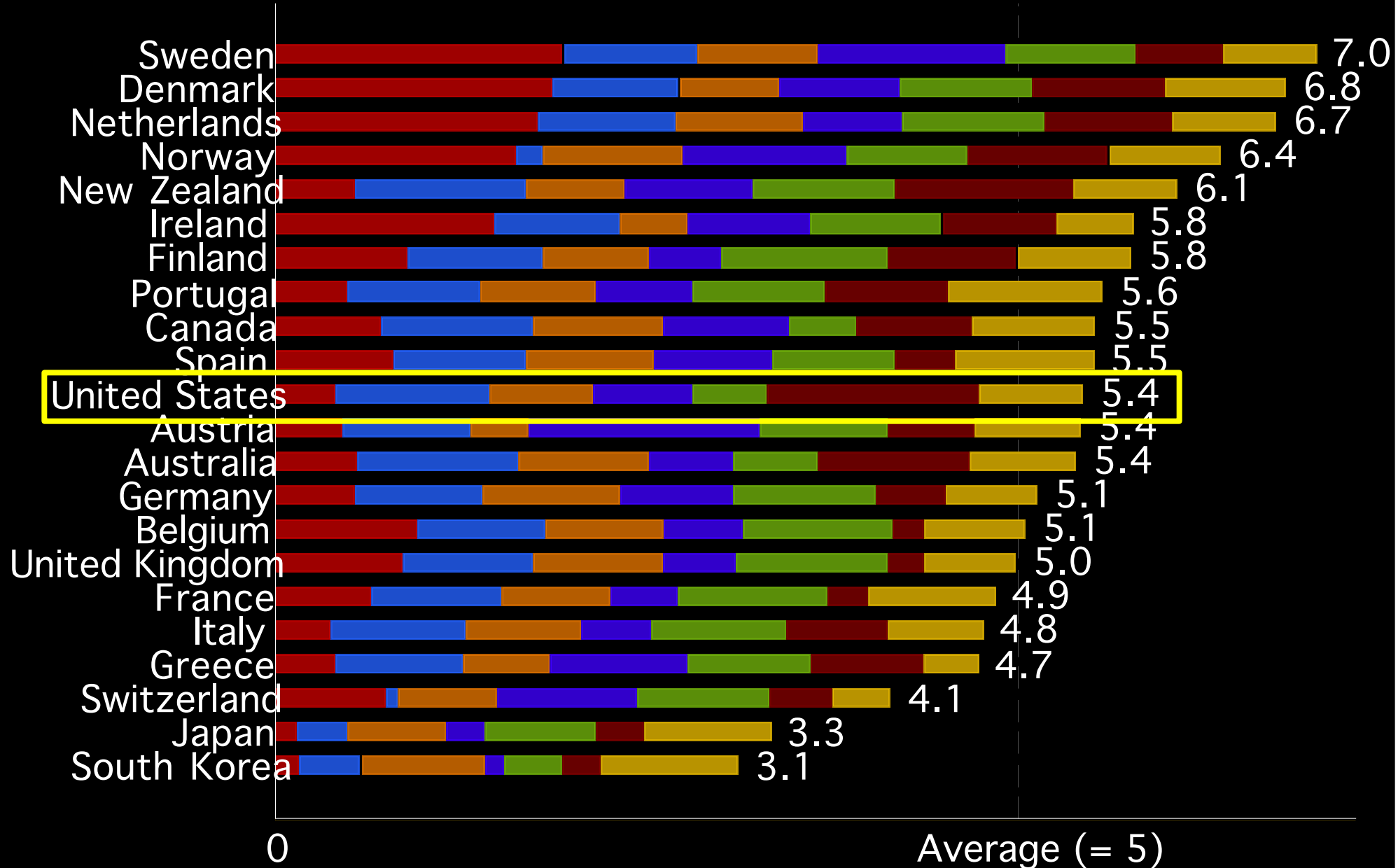
But there's more to
“aid” than aid...

2010 Commitment to Development Index



cgdev.org/cdi

Overall



0 Average (= 5)

Aid Trade Investment Migration Environment Security Technology

Aid

Quantity, net of
debt payments

Tying

Selectivity

Project
proliferation

Tax breaks for
charity



Trade

Tariffs

Quotas

Farm
subsidies

Actual imports



A woman in a blue sari is working on a watch mechanism in a factory. She is using a tool to adjust a part of the watch. In the background, other workers are visible, and there are several white circular components on the table.

Investment

Political risk
insurance

Environment and
labor screens

Fighting
international
bribery

Double taxation

More

Investment Checklist

Political risk insurance

- ✓ Multilateral Insurance?
- ✓ Official national agency?
- ✓ Agency monitors environment/labor/human rights?
- ✓ Investors in all sectors eligible?
- ✓ No inappropriate national econ interest tests?
- ✓ Restrict extending coverage to inefficient import-substituting projects?
- ✓ International companies with a significant presence in this country eligible?

Prevention of Bribery/Corrupt Practices

- ✓ OECD convention -- participation level?
- ✓ EITI Conference participation?
- ✓ Bribe Payers Index Score Quintile

Double Taxation

- ✓ Avoids double taxation?
- ✓ Lets investors enjoy developing country tax incentives?

Other FDI

- ✓ Official assistance in resolving investment disputes?
- ✓ Help businesses identify investment opportunities?
- ✓ Help developing countries set up investment promotion agencies?
- ✓ Negative advocacy

Portfolio

- ✓ Official support for design of developing country securities institutions and regulations?
- ✓ No restrictions on pension fund investment in emerging markets?

Migration

Immigration,
especially
unskilled

Foreign
students from
developing
countries

Aid to refugees
and asylum-
seekers



A photograph of an industrial facility with several tall smokestacks emitting thick, dark plumes of smoke that rise into a hazy, orange-tinted sky, suggesting a sunset or sunrise. The smokestacks are silhouetted against the bright sky.

Environment

Greenhouse
gas emissions

Gas taxes

Fishing
subsidies

Tropical timber
imports

More



Security

\$ + personnel
to U.N.
peacekeeping

Personnel to
non-U.N.

Arms exports

Protecting
sea lanes

Technology

Generation:

- Public R&D spending
- Tax breaks for R&D

Diffusion:

- Limiting intellectual property rights



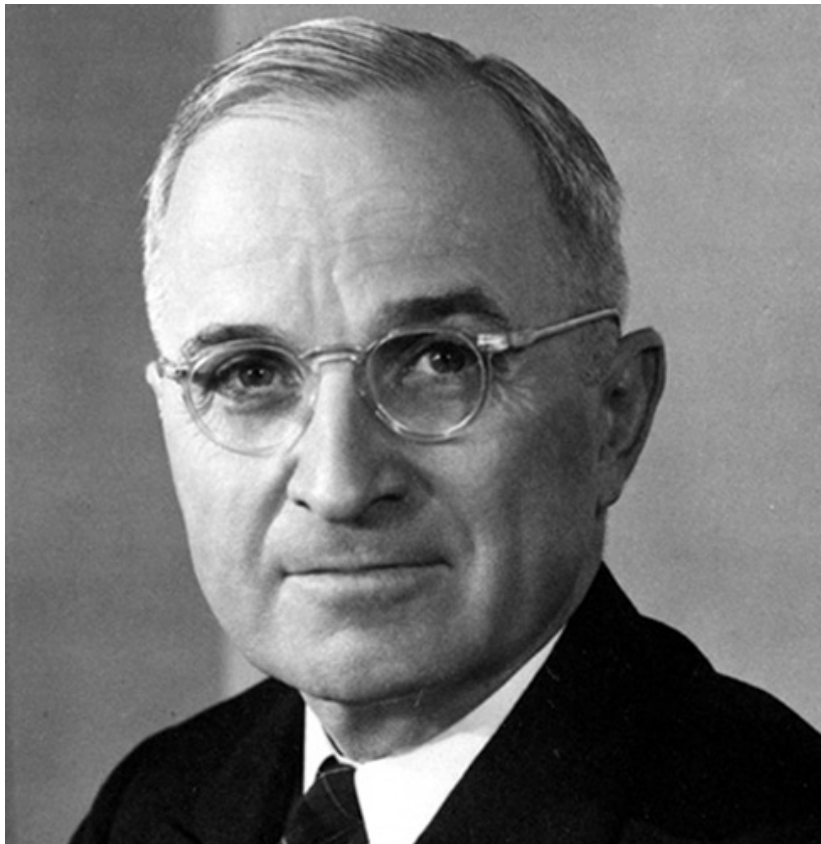
Shifting views on aid?

A short history of US Foreign Aid

After World War II

- The success of the Marshall Plan
- Newly independent countries
 - 1946: Philippines
 - 1947: India, Pakistan
 - 1948: Sri Lanka, Burma
 - 1949: Indonesia, Laos, China (PRC)
 - 1956: Morocco, Sudan, Tunisia
 - 1960: Nigeria, Chad, Senegal, Benin, Burkina Faso, Madagascar, Mali, Congo, Democratic Republic of Congo, Togo
 - 1963: Kenya
- Aspirations for industrialization and modernization

Foreign Economic Assistance Act (1950)



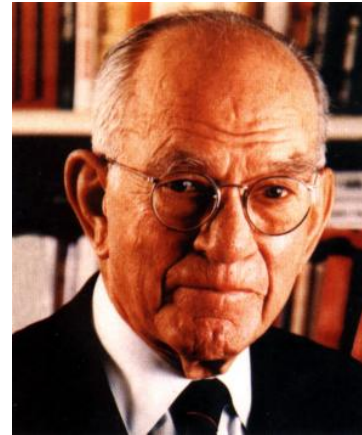
“We must embark on a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas.”

- President Harry Truman, Second inaugural address, 1949. “Four Points Speech” with development assistance as point 4.

The legacy of Vietnam



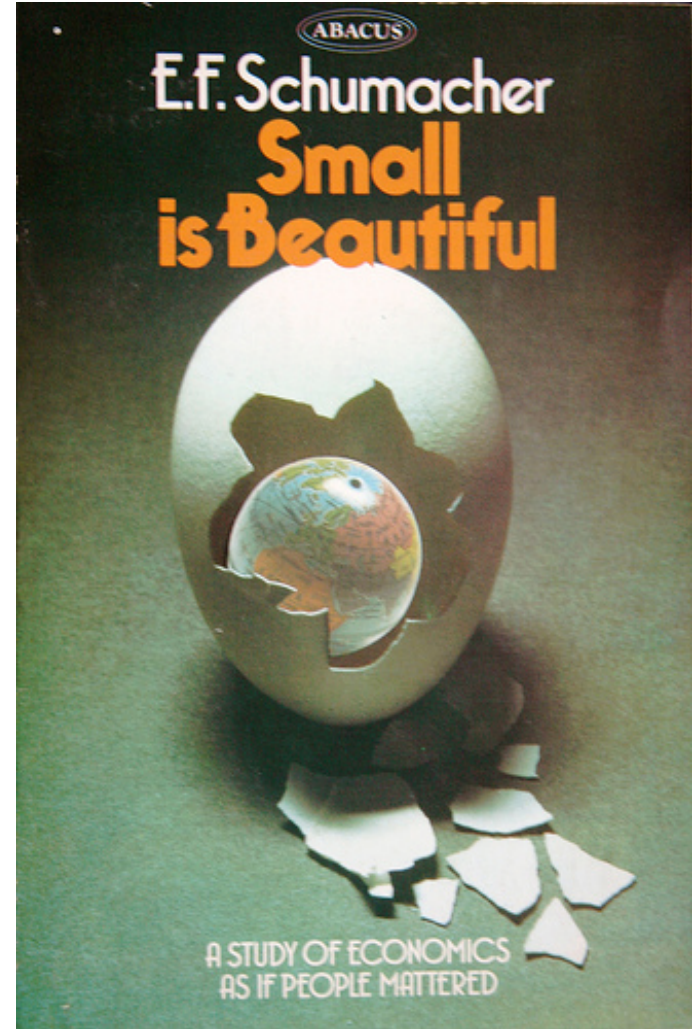
MSNBC Media



“The cause of our difficulties in southeast Asia is not a deficiency of power but an excess of the wrong kind of power which results in a feeling of impotence when it fails to achieve its desired ends.” – J. William Fulbright (1967). *The Arrogance of Power*.

U.S. Government photo

Small is beautiful



New Directions in Foreign Assistance



Principles of a bottom-up development strategy:

- Engage the poor directly as active participants in the development process
- Integrate women more fully into development efforts
- Give private and voluntary organizations, rather than just government officials, a large role in project planning, implementation, and evaluation

“The Foreign Assistance Act which I have signed today represents evidence of the continuing commitment of the United States to provide assistance to the less developed nations of the world.”

New Directions in Foreign Assistance

Country	List of Unfunded Projects
Cameroon	Trans-Cam railroad, third stage
Ghana	Hydroelectric dam, wood processing
Liberia	Expansion of telecommunication loan
Malawi	Pulp/paper production
Malawi, Botswana, Swaziland, Lesotho, etc.	Roads
Mauritius, Senegal and Mali	Hydro and irrigation dams
Rwanda	Conservation project
West Africa	Telecommunication project
Tunisia	National engineering school
Bolivia	Medium-large farmer project
Honduras	Urban development
Bangladesh	Shallow tubewells (benefit large farmers)
Pakistan	Bread factories in big cities
Indonesia	Trans-Java highway; Bandung power distribution; East Kalimantan power generator; Gresik cement, second expansion; Luwu regional development: Airstrip and harbor sections, medical hospital, and major dams
Thailand	Urban health centers

Source: Page 41, "Implementation of 'New Directions' in Development Assistance." Prepared by the Agency for International Development. July 22, 1975. Appendix 2: List of Unfunded Projects proposed to Agency for International Development (AID) missions in the past 2 years- either formally or informally- which AID did not agree to finance as they were inconsistent with the main emphases of the new legislation.

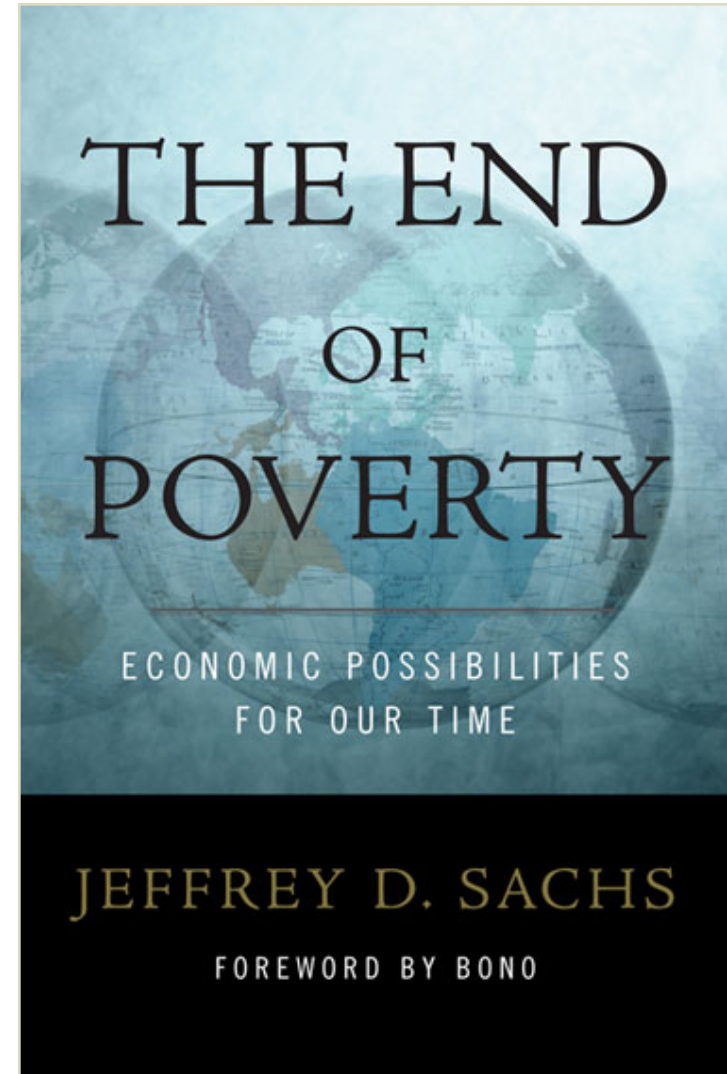
Reimagining the World Bank



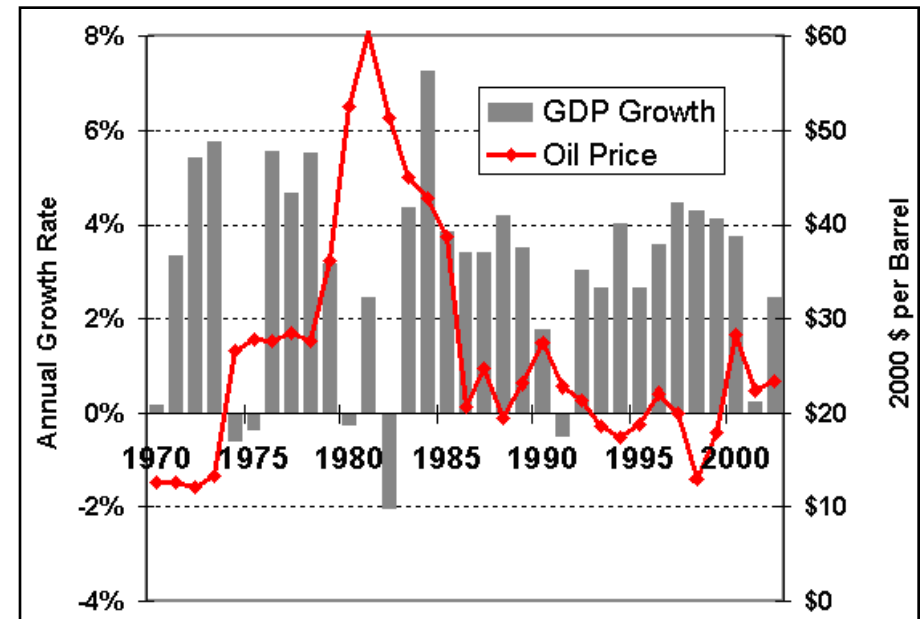
“We should strive to eradicate absolute poverty by the end of this century. That means in practice the elimination of malnutrition and illiteracy, the reduction of infant mortality, and the raising of life-expectancy standards to those of the developed nations.”

– Robert McNamara, at the 1973 Annual Meetings of the World Bank Board of Governors in Nairobi

Echo: Millennium Development Goals



Oil Crisis of 1973



Debt crisis



On August 12th, 1982, Mexico's Minister of Finance announced that the country would not be able to service its \$80 billion debt. By 1985, the ratio of debt to exports for developing countries had risen to 135.7%. That year, debt rescheduling reached a record value of \$93 billion.

The miracle of the market



“The societies which have achieved the most spectacular, broad-based economic progress in the shortest period of time are not the most tightly controlled, nor necessarily the biggest in size, or the wealthiest in natural resources. No, what unites them all is their willingness to believe in the magic of the market place.”

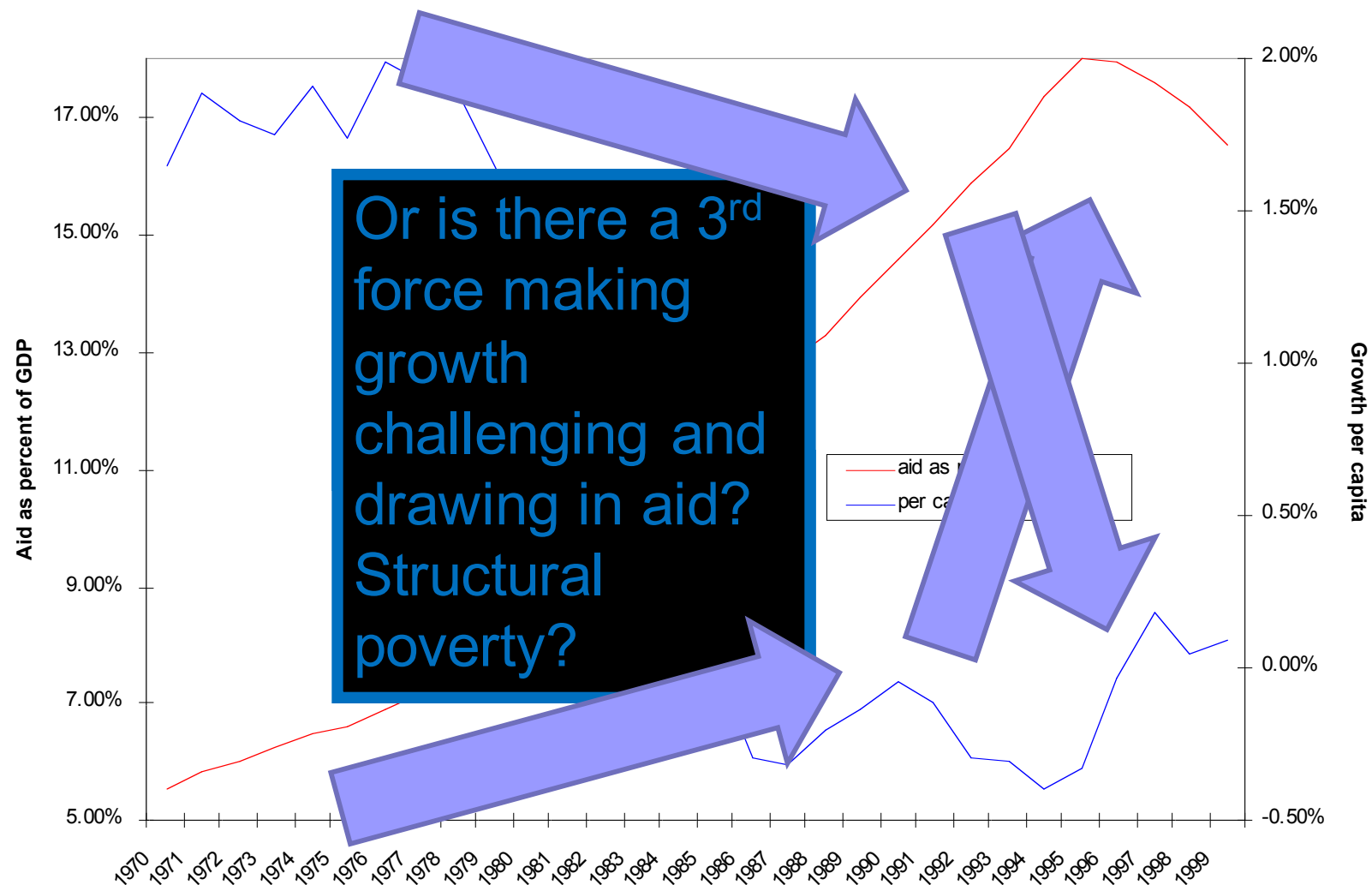
— President Ronald Reagan in 1981, addressing a joint session of the World Bank and IMF

Easterly: The “second tragedy” of foreign aid

- The first tragedy is no growth.
- But “Brown, Sachs, Bono, and Jolie are silent about the **other tragedy** of Africa’s poor.
- “This is the tragedy in which the West has spent \$2.3 trillion on foreign aid over the past four decades and has still not managed to get 12-cent medicines to children to prevent half of all malaria deaths;
- “The West has spent \$2.3 trillion on foreign aid and still has not gotten \$4 bed nets to people to prevent malaria.
- “The West has spent \$2.3 trillion on foreign aid and still has not got around to spending the \$3 per new mother that would prevent millions of child deaths from diarrhoea”

Easterly: Aid has not sustained growth over time in Africa

Figure 2: Aid and growth in Africa (10-year moving averages)



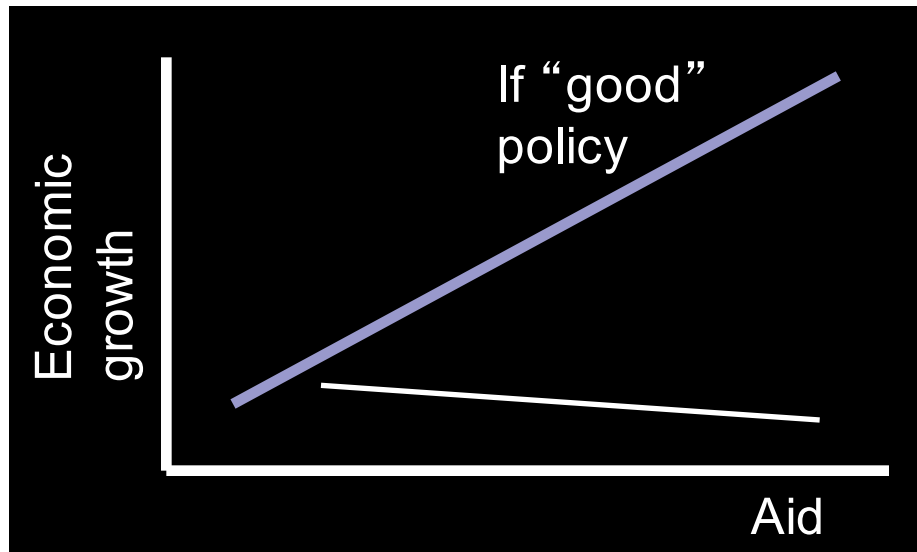
Easterly: Why is no one working on the second tragedy?

- “The key problem: aid agencies and rich country politicians are **not accountable** to the poor for the results of their aid efforts – there is nobody motivated and responsible for delivering 12-cent medicines to poor malaria victims.
- “Foreign aid agencies satisfy the demands of the rich public for feel-good moments, the feeling that “something is being done” about the first tragedy”

Evidence from Uganda

- In a famous paper Ablo and Reinikka track public expenditures in Uganda.
- Check whether budgeted expenditures in fact reach their ultimate beneficiaries.
- Staggering discrepancies, in both ways.
 - Official school enrolments stagnant; on the ground surveys show 60% increase.
 - Less than 30% of budget for non-salary expenses actually reached schools.
 - Generally budgeted salaries did reach, except until 1993 20% of teachers were ghosts.

Growth, foreign aid, and the role of “good” policy



The Fear

(Easterly et al.)

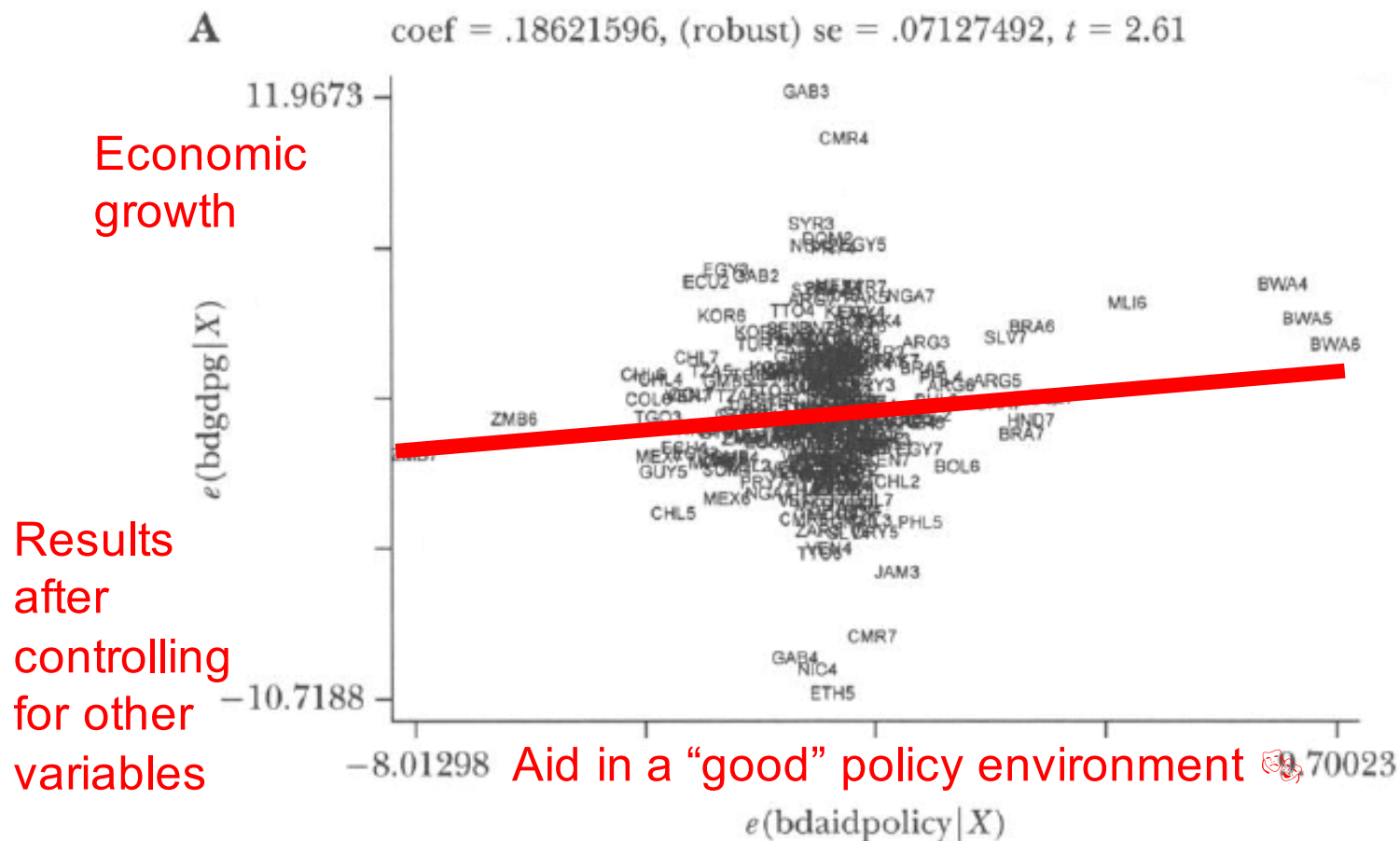
The Hope

(Burnside and Dollar)

The evidence, round 1

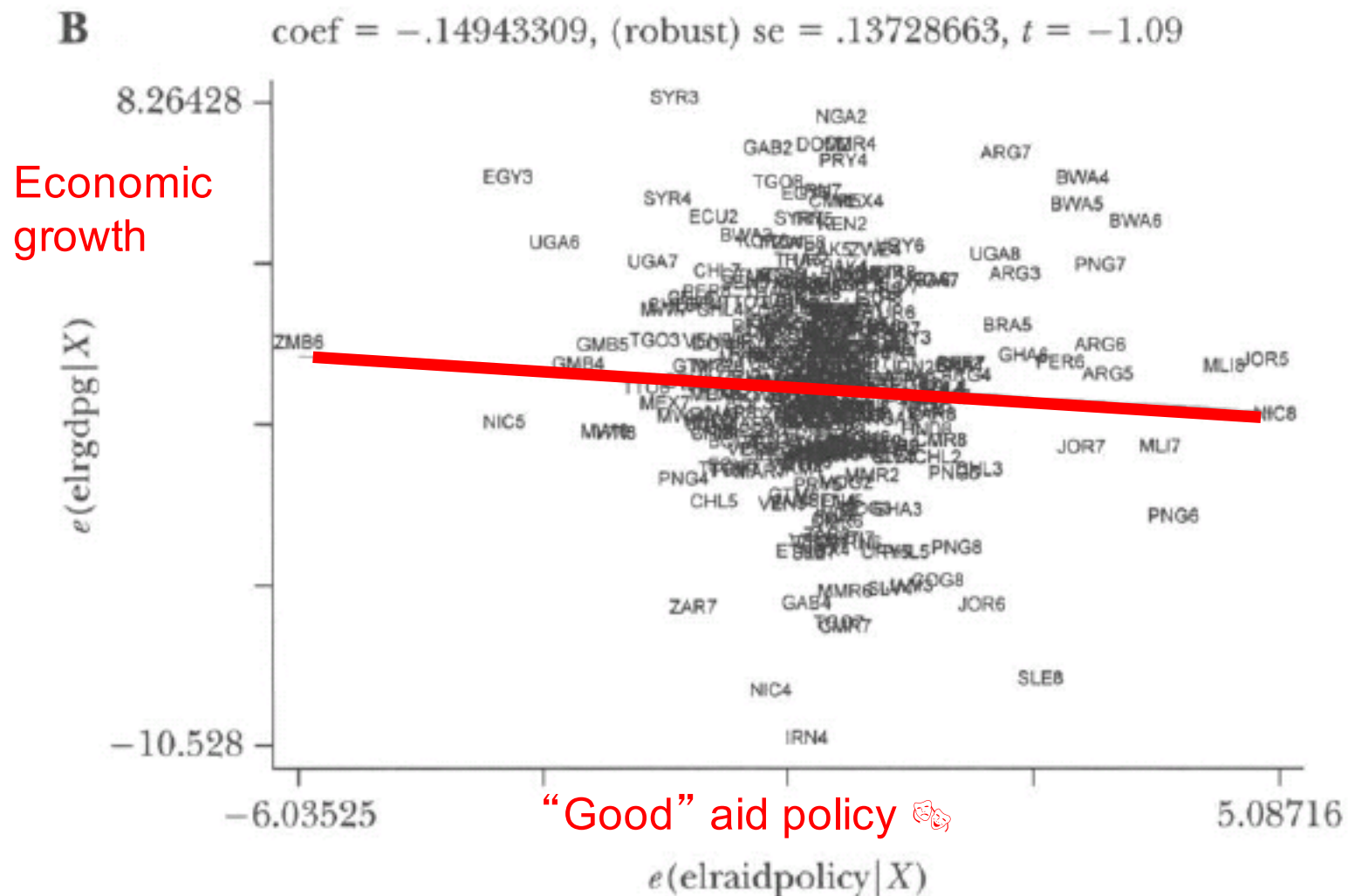
Figure 1

Partial Scatters of Growth against Interactive Aid and Policy Term



Source: Burnside and Dollar (2000).

The evidence, round 2



Source: Easterly, Levine and Roodman (2003).

Where to from here?

- Is the cross-country data where we should be looking? Historical analysis?
 - Why is “economic growth” the key variable of interest?
 - Is it appropriate to lump all aid (humanitarian, economic, etc) into one category?
- ➔ Addressing these issues only changes the picture somewhat...

Where to from here: establishing the need for causality

- Simple correlation of aid and outcomes (aid goes in, things get better/ worse) means nothing causal.
- One approach, which is slowly getting applied is randomized controlled trials (see Banerjee and Duflo book).
- Things that seem obviously good may end up not doing anything good, even harm.

Example 1: MDG/V's

- There has been a major controversy on evaluation of the MDV's.
- Project claims are shifting (shifty).
 - In part, evaluation isn't needed/ possible:
 - The MVP is not testing a rigid protocol for implementing MDG-based systems. The emphasis is community learning, design, and local context.
 - In part it is too soon to evaluate:
 - The MVP is a ten-year project running through 2015, the deadline year for the Millennium Development Goals (MDGs), and has a corresponding time horizon for evaluation.

Example 1: MDV's

- Having said that they did publish some feel-good data (Harvests of Development) which makes them fair game.
 - Data show great before-after improvements.
- Here Clemens and Demombynes argue the data shows less impact.
 - Neighboring non MDV areas also show improving trends. Taking these into account MDV's effects are less dramatic.

Example 2: OPEC foreign aid

- Ordinary least squares (OLS) regression does not give a causal relationship.
 - Shows correlation of aid and growth
- Two-stage least squares (2SLS):
 - Need an “instrument” that “causes” aid and that does not reflect situation in recipient countries
 - E.g. oil price increases lead to more aid from OPEC countries (but also affect growth)
 - Trace impact of aid as it relates to the instrument.

OPEC aid rises with oil price

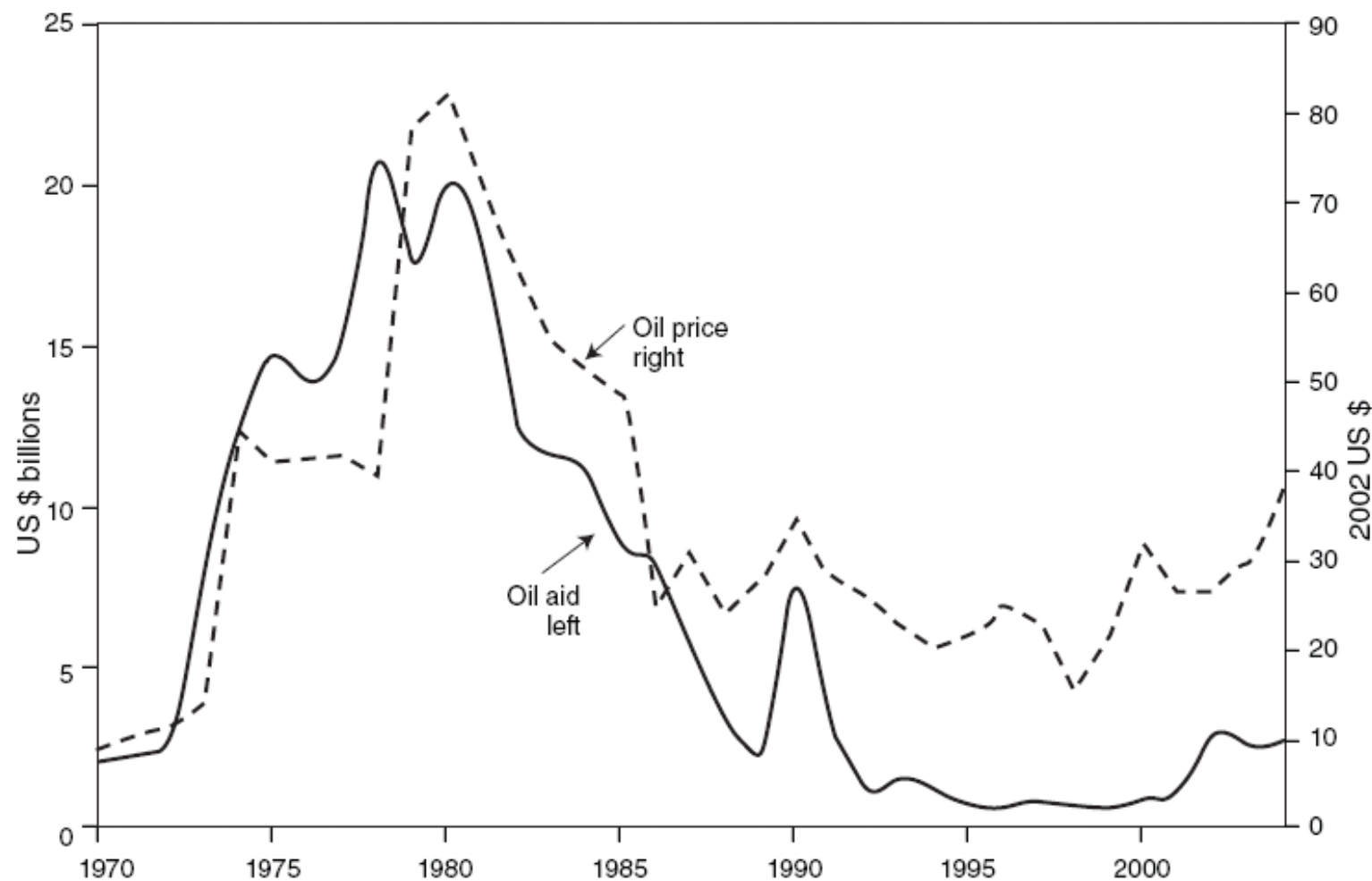


FIGURE 1. OIL PRICE AND OPEC AID FLOWS

Notes: For oil aid, we sum non-Development Assistance Committee (DAC) bilateral with Arab multilateral Office Development Assistance (ODA) flows and weight to 2002 US dollars using the Organization for Economic Co-operation and Development (OECD) DAC deflator. Aid data are from the OECD. Oil prices are in 2002 US dollars and from British Petroleum. Aid data are annual but smoothed.

The numbers

A 1% ↑ in aid leads to a x% increase in...

	GDP growth	Household consumption	Imports as % of GDP	Capital imports as % of GDP	Non-capital imports as % of GDP	Automobiles as % of GDP	Savings as % of GDP
Base specification	0.22%	0.727	1.329	0.221	0.501	0.282	-0.733
	(0.122)*	(0.225)***	(0.253)***	0.083)***	(0.187)***	(0.107)***	(-0.191)***
Robust specification	-0.027	0.904	1.562	0.194	0.245	0.303	-1.143
	-0.095	(0.390)**	(0.407)***	(0.104)*	-0.191	(0.119)**	(0.304)***

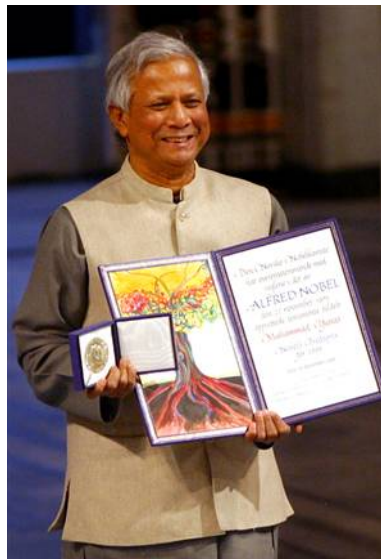
Easterly: Searchers vs. Planners

■ Planner:



Jeffrey Sachs
(The MDG
approach –
build a better
plan)

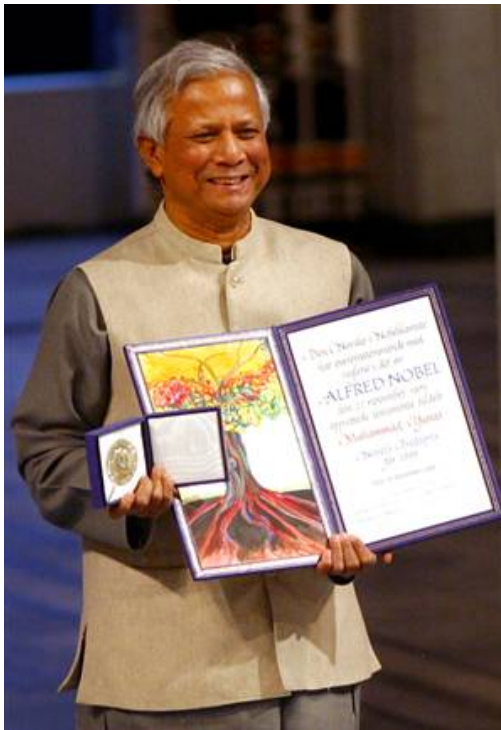
■ Searcher:



Mohammad
Yunus
(The
microfinance
approach)

Easterly: Role of donors

1. Find searchers
2. Give searchers money
3. Feedback and then...
4. Hold them accountable
5. Hold yourself accountable to taxpayers



The Norwegian Nobel Institute



Robin Saidman