

Econ 340

Lecture 21 International Policies for Economic Development: Aid

Lecture 21

Outline: International Policies for Economic Development: Aid

- Why Should We Care?
- Who Gives Aid?
- Does Aid Work?
- Pros and Cons of Aid
- Policy Recommendations
- Where We Stand in Development

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Why Should We Care about Poverty in Other Countries?

- Best reason: Morality, ethics
 - Need has been stressed by many
 - Example: Bob Geldof - rock star (is he still?)
 - Video series Geldof in Africa (2005)
 - Documented that "War, Famine, Plague and Death are the four horsemen of the Apocalypse and these days they're riding hard through the back roads of Africa."
 - Organized "Live" concerts to promote aid to poor countries
 - "Live Aid" in 1985
 - "Live 8" in 2005 (ahead of G8 meeting)

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Why Should We Care about Poverty in Other Countries?

- Self interest (see Rice)
 - (Note: Rice is former US Ambassador to UN and was US National Security Advisor under Obama)
 - Poverty abroad threatens US security
 - Fosters conflict
 - Terrorists take sanctuary in poorest countries
 - Extremist groups win over populations by providing services
 - Poverty breeds diseases, which may cross borders
 - SARS, bird flu, swine flu, ebola



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Why Should We Care about Poverty in Other Countries?

- Regarding conflict and poverty:
 - Rice cites study showing that probability of armed conflict within 5 years is
 - 15% at per capita incomes below \$250
 - 1% at per capita incomes above \$5,000
- Thus poverty alleviation is important for the world, because conflicts often extend outside of countries in which they begin

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Who Gives Aid?

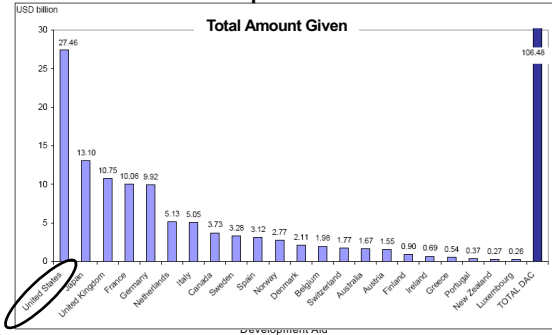
- See Economics Focus article, “Gauging Generosity”
 - Regarding aid, specifically ODA (Official Development Assistance)
 - US gives more total aid than any other country
 - But in proportion to its size, US gives less per GDP aid than any other rich country
 - The top givers are the Scandinavian countries: Denmark, Norway, & Sweden
 - Also Luxembourg and Netherlands

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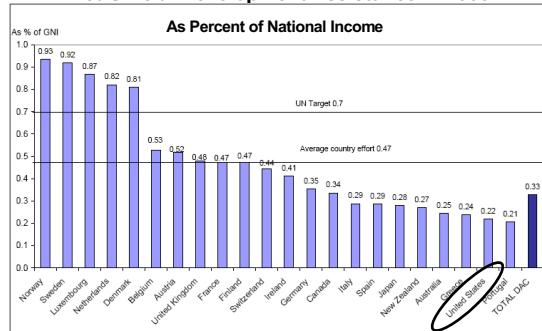
Who Gives Aid?

Net Official Development Assistance in 2005



Who Gives Aid?

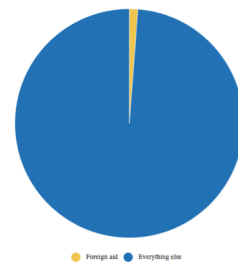
Net Official Development Assistance in 2005



US Foreign Aid in US Budget

Source:
Politifact

Foreign aid as slice of total spending



The U.S. State Department budget request for 2017 is about \$59 billion, including \$8.5 billion for health programs and \$5.8 billion in military assistance. The total U.S. budget is about \$4.15 trillion. Source: *Office of Management and Budget*

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Who Gives Aid?

- But see also Schaefer on “American Generosity...”
 - These figures ignore private aid
 - But his figures say our private aid in 2000 was \$33.6 billion.
 - That would only about triple what we give, raising our contribution to 0.45%, still well below that of Norway.
 - Schaefer also says these numbers confuse “inputs” with “outputs.”
 - He notes that many countries have done poorly even with aid.
 - So, apparently, giving only little is not a shame if giving won’t do much good.
 - But see below for how aid may be targeted more effectively

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Who Gives Aid?

- Several years ago, aid became a popular cause, pushed by Rock Star Bob Geldof
 - “Live 8” concerts, held all over the world, preceded the G8 summit conference in July 2005. Goal was to “Make Poverty History” by
 - Getting the G8 to commit 0.7% of GDP to aid by 2015
 - Eliminating agricultural subsidies
 - Eradicating disease

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- Bob Geldof and stars at the Live 8 concert in Hyde Park, which he says helped change opinions.

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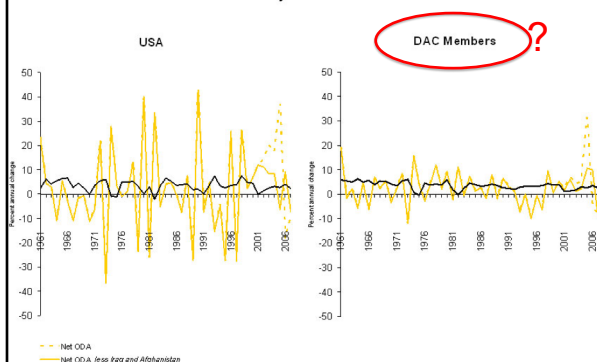
Who Gives Aid?

- For most donors, aid does not fluctuate with income
 - Fluctuations in aid are larger than fluctuations in GDP, but due to other factors (political)
 - In other words, the timing of aid is not driven by need.

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The Volatility of Aid and GNI



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Source: OECD/DAC and authors' calculations

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Who Gives Aid?

- DAC?
 - = Development Assistance Committee
 - Group of the richer countries in the OECD
 - 29 countries plus EU
 - Members confer on providing aid to developing countries.

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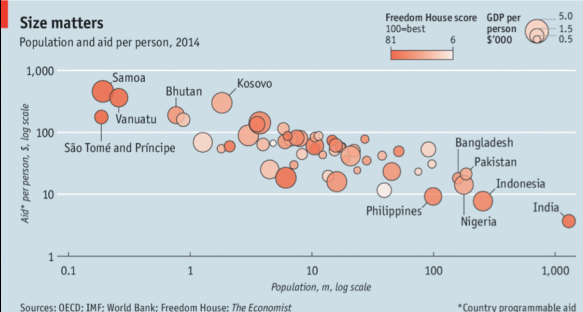
Who Gets Aid?

- See Economist: "Size Matters: Where does the aid go?"
 - Things that don't matter:
 - Being well governed
 - Being poor
 - What does matter:
 - Being small:
 - Big countries get the least aid relative to size
 - Small countries get the most

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Who Gets Aid?

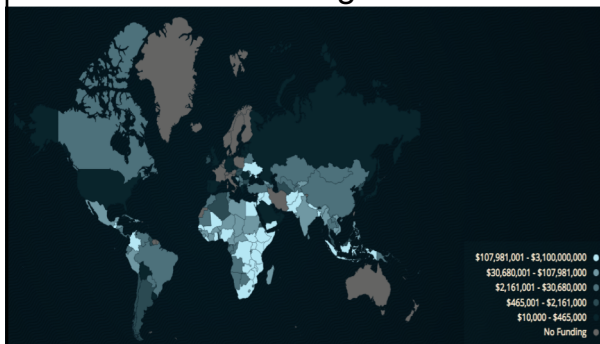


Sources: OECD; IMF; World Bank; Freedom House; The Economist

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Who Gets US Foreign Assistance?



Source: US State Dept.

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This reports: Spent, 2018

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Does Aid Work?

- Not always: Many countries that have gotten aid have become poorer
- Most attempts to find evidence of a positive effect of aid on economic growth have failed
 - Rajan and Subramanian (not assigned) looked at experience of many countries over 1960-2000
 - They found no evidence that aid mattered for growth
 - Policies and institutions of countries did not matter
 - Type of aid did not matter
 - This does *not* mean that aid doesn't reduce poverty; they didn't look at that (they looked at growth)

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Does Aid Work?

- Eberstadt and Adelman (assigned reading) review the track record of aid:
 - "...it has not been demonstrated that official development assistance makes a regular and predictable contribution to overall macroeconomic growth."
 - "The [World] Bank's evaluation unit found that its poverty reduction record remains problematic."

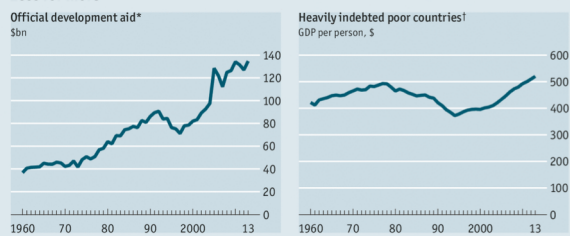
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Does Aid Work?

- Economist, "Aid to the Rescue" 2014

Less for more



*From Development Assistance Committee members, 2012 prices and exchange rates
†39 mainly sub-Saharan countries, 2005 dollars

Sources: OECD; World Bank

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Does Aid Work?

- Economist, "Aid to the Rescue" 2014
 - Cites new work that shows positive causal link between aid and growth
 - Answering this question is hard because causation goes both directions
 - Study cited uses as "instrumental variable": crossing the \$1,200 per capita income threshold where aid is cut off
 - But effect is small, and may not be worth the money spent, even though aid is still well below the target of 0.7% of GDP

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Does Aid Work?

- Economist, "Aid to the Rescue" 2014
 - Reasons why aid may be harmful:
 - Fostering dependency
 - Propping up oppressive or incompetent regimes
 - Pushing up the value of poor countries' currencies, thereby undermining the competitiveness of their exports

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Pros and Cons of Aid

- Pro: Much is needed
- Con: Much is wasted

How Aid Is Wasted

- Example: Côte d'Ivoire (See Fraser Institute: "When Foreign Aid Doesn't")
 - Country was turned from being an economic miracle to a disaster by foreign aid
 - Grew at 8% a year for 35 years after World War II
 - Moved toward state control starting in 1960s
 - Foreign capital for development went to large "inefficient" projects benefiting the ruling class – hydroelectric plants, and new capital city
 - Health spending went mainly to the wealthy urban population
 - 50-80% of education spending on higher education, benefiting the wealthy elite, while 40% of children 6-12 do not attend school
 - GDP fell 4.3% per year from 1985 to 1994

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Policy Recommendations

- Jeff Sachs, famous advocate for greater aid (not assigned)
 - Steps out of poverty:
 - Boost food production to end famine.
 - Improve health conditions.
 - End economic isolation (thus trade, or more generally, what he calls "connectivity")

Policy Recommendations

- Jeff Sachs
 - Standards for successful aid
 - Targeted
 - Specific
 - Measurable
 - Accountable
 - Scalable
 - Should support “triple transformation” in agriculture, health, and “connectivity”

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Policy Recommendations

- William Easterly, famous aid skeptic (not assigned)
 - Critic of Sachs, and of aid as it is mostly done
 - What is needed, he says: CIAO
 - C = Customer Feedback
 - I = Incentives
 - A = Accountability
 - O = Outcomes
 - Existing programs, including those pushed by Jeff Sachs, have none of this (he says)

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Policy Recommendations

- Easterly also has pointed out
 - Africa is doing better than the activists suggest
 - Bob Geldof's “Four Horsemen” – War, Famine, Plague & Death -- are actually not common
 - e.g., annual war deaths have averaged 1 per 10,800 for 4 decades
 - Recent growth has been highest in Africa's history
 - Failure to meet the Millennium Development Goals is understandable, given the low start
 - Africa actually made good progress toward them

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Policy Recommendations

- Improve developing country governments and policies
 - Importance of Economic Freedom
 - Millennium Challenge Account (see Roberts)
 - This is a US program begun 2004 that gives aid to developing countries only if they demonstrate the ability to use it productively with
 - Good policies
 - Responsible government
 - Needed because so much foreign aid has been wasted

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Policy Recommendations

- What about Tied Aid and Food Aid?
 - Tied Aid: Money that must be spent on the donor's exports
 - Inefficient, since a developing country could usually get more value buying elsewhere
 - See Economist
 - Food Aid: Agricultural products given directly to countries
 - Products chosen to support farmers in donor country
 - Effect on competing farmers in LDCs can be serious
 - But see Levinsohn and McMillan:
 - In Ethiopia, the farmers are not poor, so food aid does help the poor

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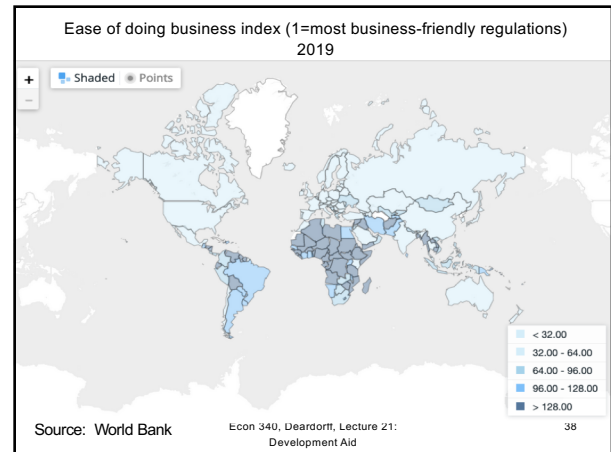
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Policy Recommendations

- “Doing Business”
 - World Bank, each year, measures the ease of doing 10 different activities in each of 190 countries. Examples
 - Starting a business
 - Getting credit
 - Enforcing contracts
 - It publishes country rankings
 - This puts pressure on countries to improve

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Where We Stand in Development

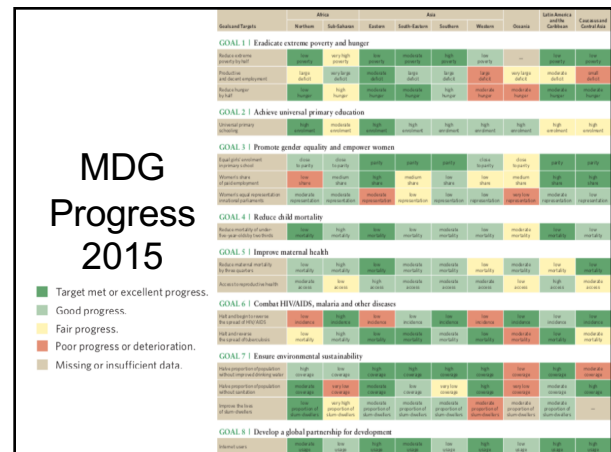
- Millennium Development Goals (MDGs)
 - 8 goals identified and agreed in 2005 by the United Nations to be achieved by 2015
 - Overall there was significant progress, and many countries achieved the MDGs
 - Many others did not, but many of them too made good progress

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Where We Stand in Development

- The MDGs
 1. Eradicate Extreme Poverty and Hunger
 2. Achieve Universal Primary Education
 3. Promote Gender Equality and Empower Women
 4. Reduce Child Mortality
 5. Improve Maternal Health
 6. Combat HIV/AIDS, Malaria and Other Diseases
 7. Ensure Environmental Sustainability
 8. Develop a Global Partnership for Development

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Where We Stand in Development

- Sustainable Development Goals (SDGs)
 - 17 goals identified and agreed in 2015 by the United Nations to be achieved by 2030



Next Time

- Outsourcing and Offshoring
 - Definitions
 - Effects
 - Facts
 - Policies

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