

Foreign Aid

MESHRY



What is Foreign aid?

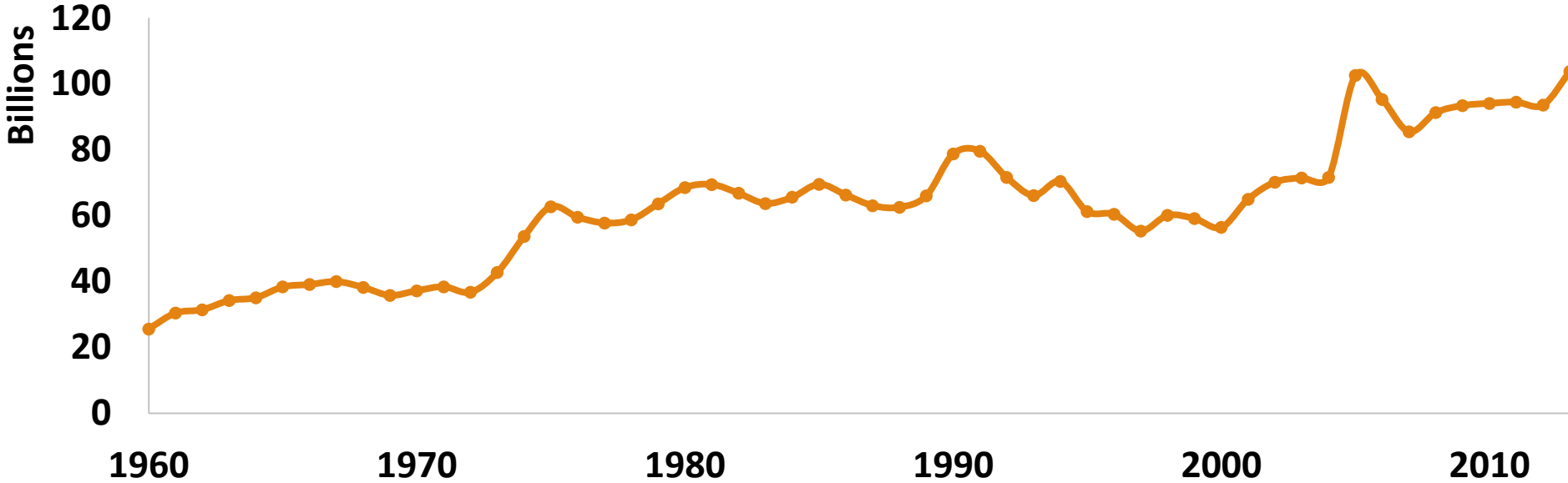
Broadly speaking there are three types of aid:

- **Humanitarian or emergency aid:** mobilized and dispensed in response to catastrophes and calamities – for example, aid in response to the 2004 Asian tsunami.
- **Charity-based aid:** which is disbursed by charitable organizations (NGOs) to institutions or people on the ground
- **Official Development Assistance (ODA):** payments made directly to governments through
 - Other governments (in which case it is termed bilateral aid)
 - International institutions such as the World Bank (known as multilateral aid).

Humanitarian aid and Charity-based aid are negligible compared to ODA.

How much money is spent in official aid?

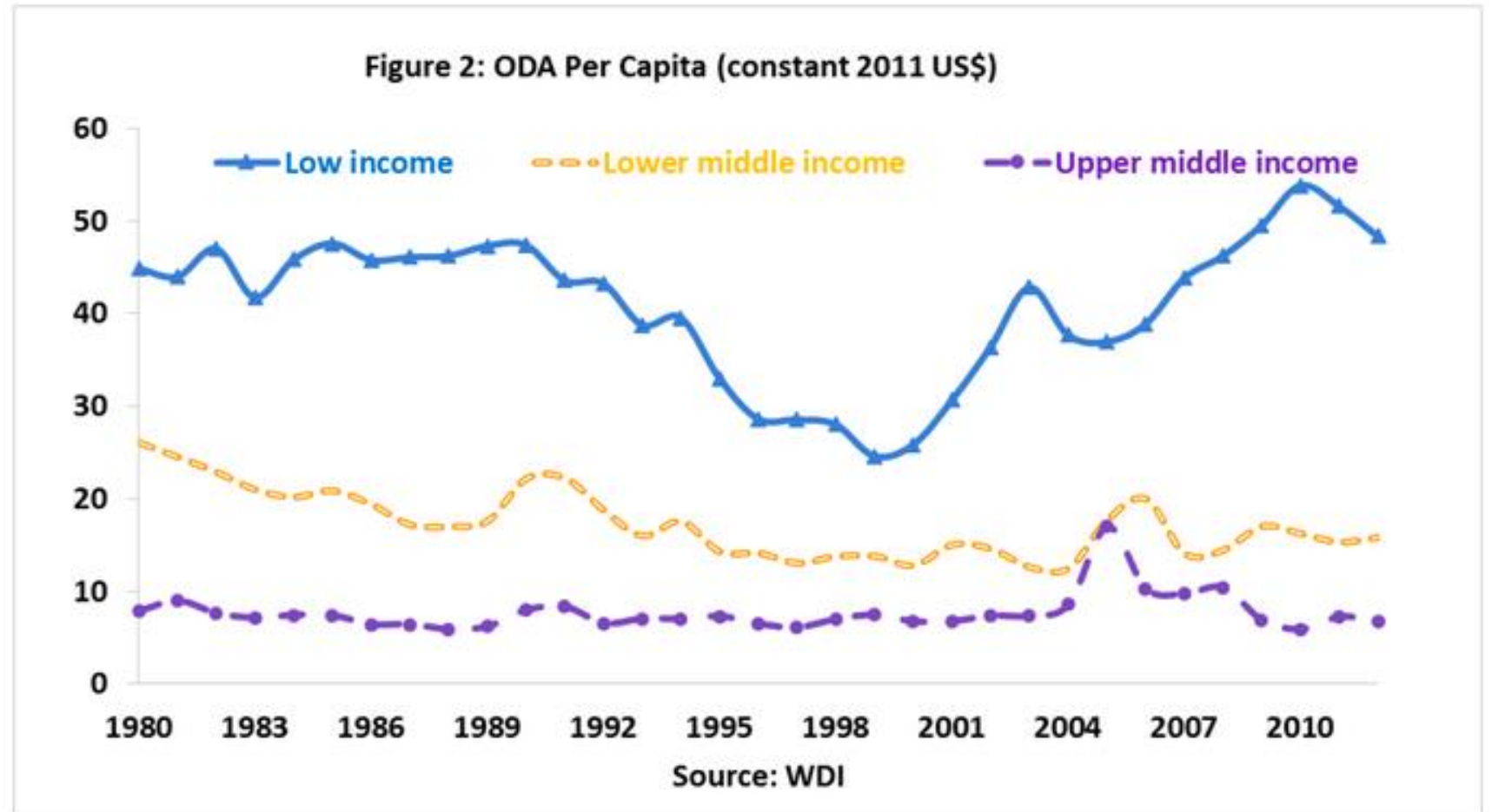
Net official development assistance received (constant 2012 US\$)



Data from database: World Development Indicators 04/14/2015

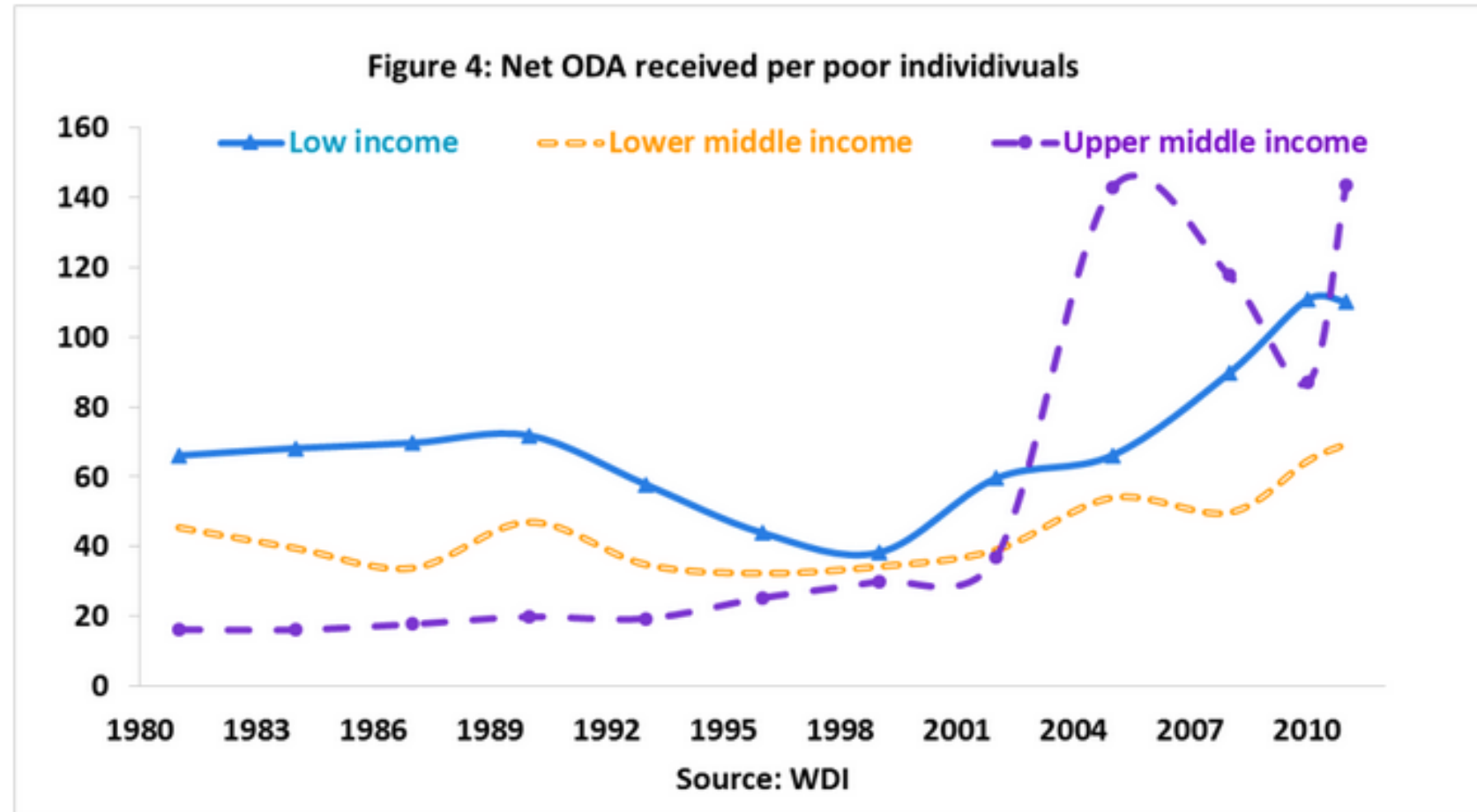
Who receives aid?

Most aid goes to low income countries and the more poor a country gets the more aid it receives.

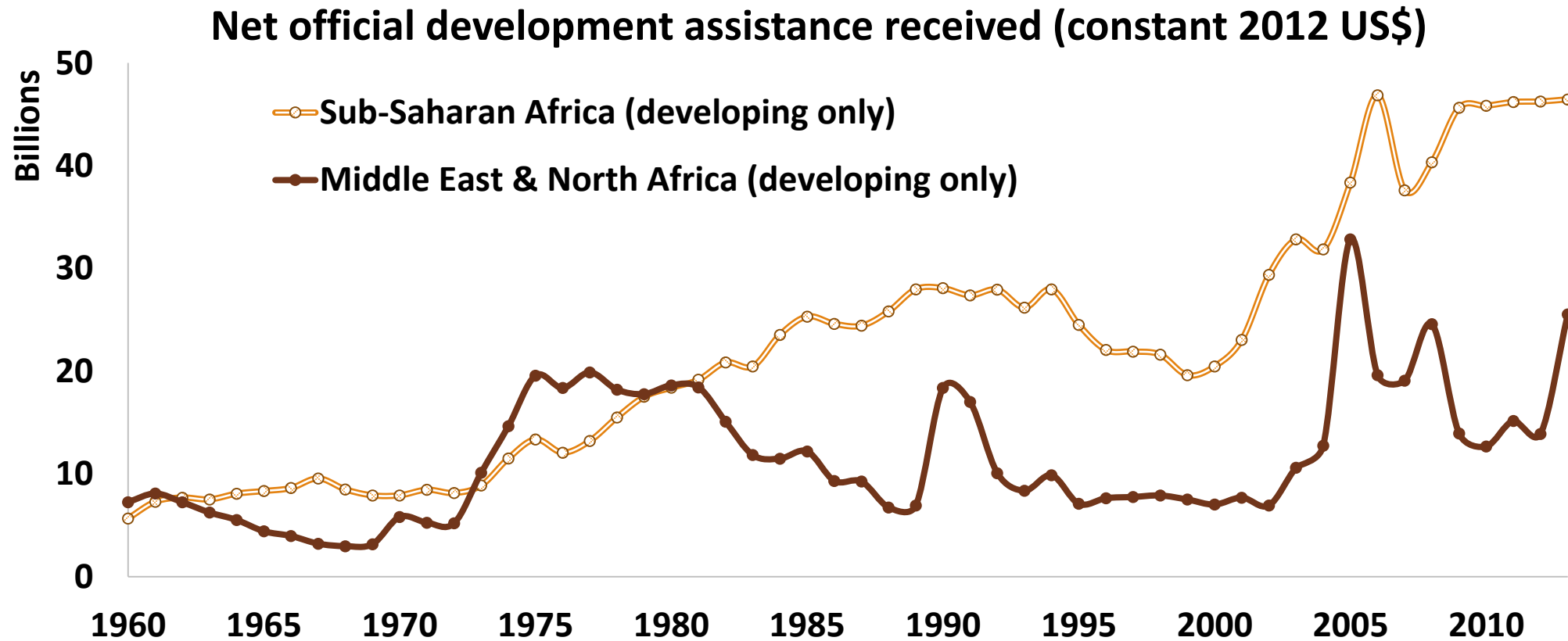


Who receives aid?

Countries with the highest number of people tend to receive the highest aid per poor person.

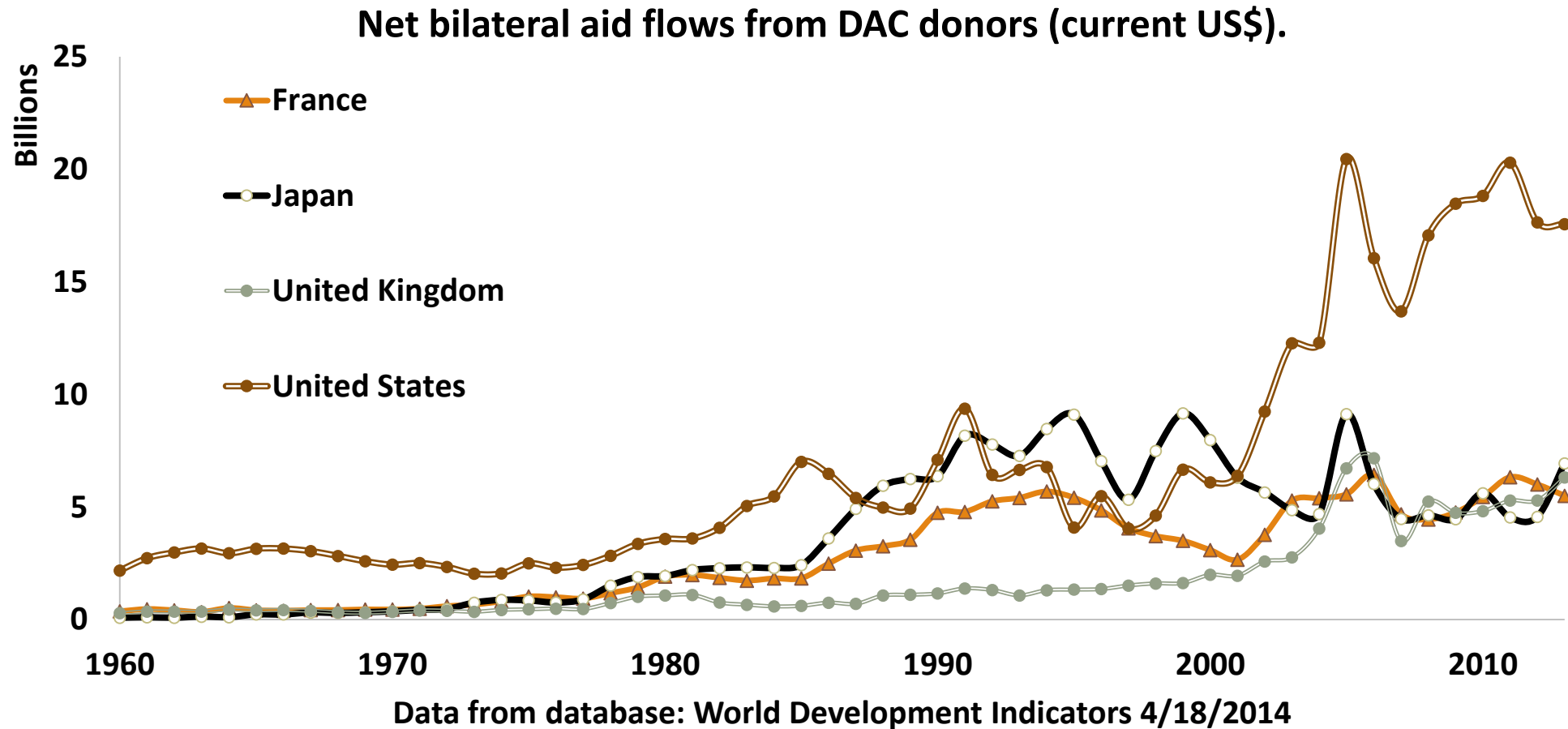


Aid to Africa



Source: WDI 04/14/2015

Who gives aid?



What is the purpose of aid?

For the Donors:

- Geopolitical interests
- Altruism

For the Recipients:

- Aid is intended to help poor countries finance and invest in:
 - Agricultural productivity to increase the yield and eliminate chronic hunger**
 - Basic Health to reduce mortality and eradicate infectious preventable diseases**
 - Education**
 - Infrastructure i.e. electricity, roads, ports, and telecommunications**
 - Security**

Does aid work?

Yes, according to Sachs

- The poor are trapped, and they lack capital.
- Aid gives them a push to break out of the poverty trap.

No, according to Moyo

- Stop reliance on aid for finance
- Issue bonds where the market
- Rely on FDI
- Focus on trade
- Make use of microfinance and remittances

Sometimes, according to Collier

- Aid for reconstruction
- Infrastructure aid for landlocked countries
- Aid to incentivize good governance, transfer skills, and reinforce incipient turnaround

Sachs: the poverty trap (Chapter 13)

- ❑ The extreme poor lack six major kinds of capital:
 - ❑ Human capital: health, nutrition, and skills
 - ❑ Business capital: the machinery, facilities, and technology
 - ❑ Infrastructure: roads, power, water sanitation, airports, seaports, and telecommunications systems

Sachs: the poverty trap (Continued)

- ❑ Natural capital: arable land, healthy soils, biodiversity, and well-functioning ecosystems
- ❑ Public institutional capital: commercial law, judicial systems, government services and policing
- ❑ Knowledge capital: scientific and technological know-how

Aid helps to jump-start the process of capital accumulation, economic growth, and rising household incomes.

Sachs: successful scalable projects

- ❑ Examples of successful aid programs that have been scaled up:
 - ❑ The green revolution in Asia
 - ❑ The eradication of Smallpox
 - ❑ The campaign for child survival
 - ❑ The global Alliance for vaccines and immunization

Sachs: successful scalable projects (Cont.)

- ❑ The campaign against Malaria
- ❑ The control of African River Blindness
- ❑ The eradication of Polio
- ❑ The spread of family planning
- ❑ Export processing zones in East Asia
- ❑ The mobile phone revolution

Sachs: aid doesn't nurture corruption, poverty does

- ❑ By almost any standard, Africa's quality of governance is low.
- ❑ Property rights are difficult to enforce, violence and crime are high, corruption is perceived to be extensive.
- ❑ However, governance and higher incomes go hand in hand not only because good governance raises incomes, but also, because higher income leads to improved governance.
- ❑ Africa's governance is poor because Africa is poor.

Sachs: Aid is not money down the drain

- ❑ Per capita aid is small to start with: just \$30 per sub-Saharan African in 2002
- ❑ Of which \$5 was for consultants from the donor countries,
- ❑ more than \$3 for food and emergency aid,
- ❑ \$4 went to servicing Africa's debts,
- ❑ \$5 was for debt relief operations.
- ❑ The rest, \$ 12, went to Africa.

Sachs: Aid is not money down the drain (Cont.)

- ❑ In 2002, the United States:
 - ❑ gave \$ 3 per sub-Saharan African.
 - ❑ Taking out the parts for U.S:
 - ❑ consultants,
 - ❑ food & emergency aid,
 - ❑ administrative costs,
 - ❑ and debt relief,
- ❑ The aid per African comes down to six cents per person.

Sachs: the rich can afford to help the poor

- ❑ There were 1.1 billion people below the \$ 1.08 poverty level as of 2001.
- ❑ Their average income was \$ 0.77 per day, \$ 281 per year.
- ❑ The poverty shortfall was $(1.08 - 0.77)$ \$ 0.31 per day, \$ 113 per year.
- ❑ The total income shortfall of the poor in 2001 was therefore $\$ 113 * 1.1$ billion, or **\$124 billion**.

Sachs: the rich can afford to help the poor (Cont.)

- ❑ The income of the twenty-two donor countries of the Development Assistance Committee (DAC) in 2001 was \$ 20.2 trillion.
- ❑ The \$124 billion income shortfall of the poor can be eliminated by a transfer of 0.6% of donor income.
(.06*20.2 trillion = 124 billion)
- ❑ Ironically, this is short of the 7% donors committed themselves to.

Moyo: aid is wrong for Africa (Chapter 3)

- ❑ Aid creates dependency
- ❑ It fosters corruption, creating a vicious cycle of aid.
- ❑ It weakens social capital
- ❑ Aid increases the risk of civil war
- ❑ Aid reduces savings and investment
- ❑ Aid can be inflationary
- ❑ Aid chokes off the export sector
- ❑ Aid causes bottle necks: Absorption capacity

Moyo: Development Finance

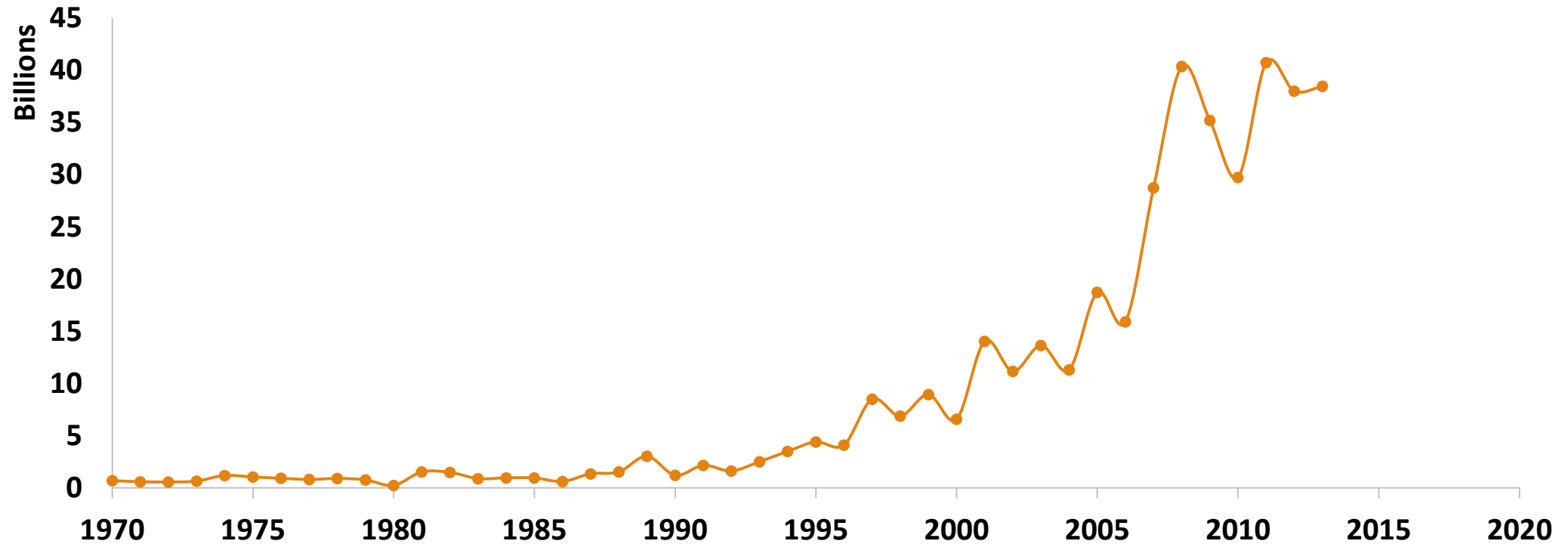
- ❑ Poor countries need cash to finance development:
 - ❑ At early stages of development, this funding is hard to generate through taxes.
 - ❑ But aid is not the solution.
 - ❑ Instead governments can rely on:
 - ❑ Capital Markets
 - ❑ Trade
 - ❑ FDI
 - ❑ Remittances

Moyo: A Capital Solution

- ❑ In 2007, Ghana and the Gabonese Republic issued US \$ 750 million and US \$ 1 billion ten-year bond in the international capital markets, respectively.
- ❑ To access capital markets governments need:
 - ❑ Acquire a creditworthiness rating and convince investors of its potential as market
- ❑ Currently, there is a high demand for investment in emerging markets, 12% return vs. 3% on us debt.
- ❑ As countries improve their credit ratings, domestic investors also get access to financial markets.
- ❑ The opportunity cost of relying on aid is that countries' never improve their credit ratings and thus domestic investors never gain access to capital markets.

Moyo: Use Foreign Direct Investment FDI

Net FDI inflows to Sub-Saharan Africa (developing only)



Moyo: FDI instead of Aid

- ❑ Economic Theory suggest that FDI should flow from rich to poor countries.
 - ❑ Japanese car manufactures moved to Europe
 - ❑ Textile industries moved to Asia
- ❑ So why doesn't FDI flow to Africa?
 - ❑ Bad Infrastructure
 - ❑ Corruption, bureaucracy, and bad regulations
- ❑ To get FDI Africa needs:
 - ❑ Understand the benefits of FDI: creating more jobs, transfer of technology, stimulate the capital markets, improve management expertise, and aid indigenous firms to open up.
 - ❑ And remove the barriers to foreign investors

Moyo: China and Africa

- ❑ China invested US \$ 900 million in Africa in 2004, up from US \$ 20 million in 1975.
- ❑ As of mid-2007, the stock of China's FDI to Africa was \$100 billion.
- ❑ For example China built:
 - ❑ Roads in Ethiopia,
 - ❑ pipelines in Sudan,
 - ❑ railways in Nigeria, and
 - ❑ power stations in Ghana.

China has technology, but needs resources; Africa needs technology, but has resources. They can compliment each other.

Moyo: Let's Trade

- ❑ Though Africa is open, it can not export its produce to the west due to trade restrictions:
 - ❑ The OECD spends \$300 billion on agriculture subsidies, (3 times the aid they give out)
 - ❑ These subsidies, reduce African exports to OECD members, costing Africa \$ 500 billion annually.
 - ❑ For example, thanks to subsidies,
 - ❑ Mali loses nearly 2 per cent of GDP and 8 per cent of export earnings;
 - ❑ Benin loses almost 2 per cent of its GDP and 9 per cent of export earnings;
 - ❑ Burkina Faso loses 1 per cent of GDP and 12 per cent of export earnings.

African Growth and Opportunity Act (AGOA)

- ❑ AGOA opens US markets to a range of African products, especially textiles.
- ❑ For example, apparel imports from African countries into the US are duty-free.
- ❑ **However, duty-free apparel imports from African countries are capped at 3% of total US imports!**
- ❑ In 2003, AGOA exports were worth more than US \$ 14 billion.
- ❑ However, only “rich” African countries benefited from AGOA.
- ❑ Nigeria, South Africa, and Gabon account for more than 90 per cent of AGOA duty-free benefits.
- ❑ Also, petroleum products accounted for 80 per cent, with textiles and clothes accounting for US \$ 1.2 billion.
- ❑ AGOA grants the special waiver for only one year at a time, and AGOA itself is only guaranteed for three years.

Collier: The four traps

- ❑ The bottom billion poor live in countries caught in one or more of the following four traps:
 - ❑ The Conflict trap
 - ❑ The natural resource trap
 - ❑ The trap of being landlocked
 - ❑ The trap of bad governance in a small country

Collier: The conflict trap (Chapter 2)

- ❑ 73% of the bottom billion have recently been through a civil war or are still in one.
- ❑ Civil war is much more likely to break out in low-income countries
- ❑ Halve the starting income of the country and you double the risk of civil war.
- ❑ Civil war tends to reduce growth by around 2.3% per year, so a 7-years war leaves a country around 15%.
- ❑ The cost of a typical civil war to the country and its neighbors can be put at around \$64 billion. The global cost has been over \$100 billion a year, double the global aid budget.

South Sudan and the conflict trap



Collier: Aid and the Conflict Trap (Ch.7)

- ❑ On average, aid has no direct effect on the risk of civil war, though it has indirect effects
- ❑ But, big aid makes a coup more likely.
 - ❑ This is because rebellions are encouraged by natural resource wealth but not by aid, while coups are encouraged by aid.
- ❑ So, to what extent does aid make the conflict trap worse?
 - ❑ Rebellions and coups reduce growth
 - ❑ Aid increases growth and thereby reduces the risk of rebellions and coups.
- ❑ In countries with better governance, aid pays off by reducing the risk of civil war more and inducing coups less.
- ❑ In countries with weak governments, aid doesn't pay off. It barely increases growth while significantly inducing coups.
- ❑ In post-conflict situations, the security benefits alone are more than enough to justify large aid programs. [See this report](#).
- ❑ Aid can also shorten the time that a failing state is stuck.

Collier: The Natural Resource Trap (Ch. 3)

- ❑ Reliance on resource exports causes a country's currency to rise in value against other currencies.
- ❑ This makes the country's other export activities uncompetitive.
- ❑ This is called the "Dutch Disease" after the effects of North Sea gas on the Dutch economy.
- ❑ In addition, natural resource revenues are volatile and lead to economic crises.
- ❑ Moreover, resource rents make democracy malfunction.

Collier: Aid and the trap of bad governance (Ch. 7)

- ❑ There are three ways in which aid can help turnarounds:
 - ❑ Aid as an incentive for good policies
 - ❑ Instead of conditioning aid on future performance, donors should reward good performers ex post.
 - ❑ Aid as a transfer of Skills
 - ❑ Countries of the bottom billion are characterized with low-skilled civil service. Aid has a potential role of providing the necessary skills.
 - ❑ Technical assistance during the first four years of an incipient reform, and especially during the first two years, has a big favorable effect on the chances that the momentum of the reforms will be maintained.
 - ❑ Aid as reinforcement
 - ❑ Aid money during the first few years of an incipient reform is counter productive.
 - ❑ However, after a few years of reform with technical assistance, aid money starts to become effective.

Collier on aid and military intervention (Ch. 8)

- ❑ There are three important roles for external military intervention:
 - ❑ Restoration of order,
 - ❑ Maintaining post-conflict peace,
 - ❑ Preventing coups.

Collier: Laws and Charters (Ch.9)

- ❑ The rich countries have been a safe haven for the criminals of the bottom billion.
- ❑ Western banks have taken deposits looted from the bottom-billion societies, held the money in great secrecy, and refused to give it back.
- ❑ Until very recently, if a French company bribed a public official in a bottom-billion society, the payment was tax deductible. Think it through: French taxpayers were subsidizing bribery.
- ❑ For this, Collier advocates the following:
 - ❑ A Charter for Natural Resource Revenues
 - ❑ A Charter for Democracy
 - ❑ A Charter for Budget Transparency
 - ❑ A Charter for Post-conflict Situations
 - ❑ A Charter for Investment

Success story: [The global fund for Fighting AIDS, Tuberculosis and Malaria](#)



Success Story: President's Emergency Plan for AIDS Relief (PEPFAR)



References

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- Deaton, A. S. (2009). [Instruments of development: Randomization in the tropics, and the search for the elusive keys to economic development](#) (No. w14690). National Bureau of Economic Research.

Readings

Collier 2007 The Bottom Billion [Excerpts](#)

Collier's Chapters 8 & 9 on [Intervention and Laws & Charters](#)

Collier's [Chapter 2 on the Conflict Trap](#)

Ferguson's [Review](#) of Collier's the Bottom Billion

Dambisa Moyo's Chapt9: [Banking on the Unbanked](#).

Dambisa Moyo's Dead Aid: [Forward](#)

Sachs 2005 Chapter 12 [Selected Pages](#)