

ECON B224: ECONOMIC DEVELOPMENT

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Redistribution and Foreign Aid

What is Foreign Aid? Some Definitions

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- **Foreign aid** is the mechanism through which rich countries transfer resources to poor countries
- **The system** that facilitates this is often referred to as the “international development system”. Comprised of various actors:
 - ▣ Multilateral Institutions: The World Bank, Regional Development Banks (Example: African Development Bank), United Nations Development Programme, etc.
 - ▣ Unilateral Govt. Agencies: US Agency for International Development (USAID), UK Department of International Development (DFID)
 - ▣ Non-governmental Organizations: MercyCorps, Oxfam, Catholic Relief Services
 - ▣ For-profit Social Enterprises: Sanergy, Jahudi Kilimo, many others
 - ▣ For-profit Contractors: Chemonics, Development Alternatives Inc. (DAI), Management Systems International (MSI)
- **The process** foreign aid supports is “international development”

Two Broad Modalities of Aid

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- **Traditional: Goes to recipient government**
 - ▣ Helps budget and increase public spending on infrastructure and public services
- **“Newer Trend”:** Worry of corruption in the government $\Rightarrow$ Aid Channeled directly to **domestic civil society organizations** (community groups and domestic NGOs)
 - ▣ Concern: Does this weaken the state?

Past Trends in Aid: Who Donates?

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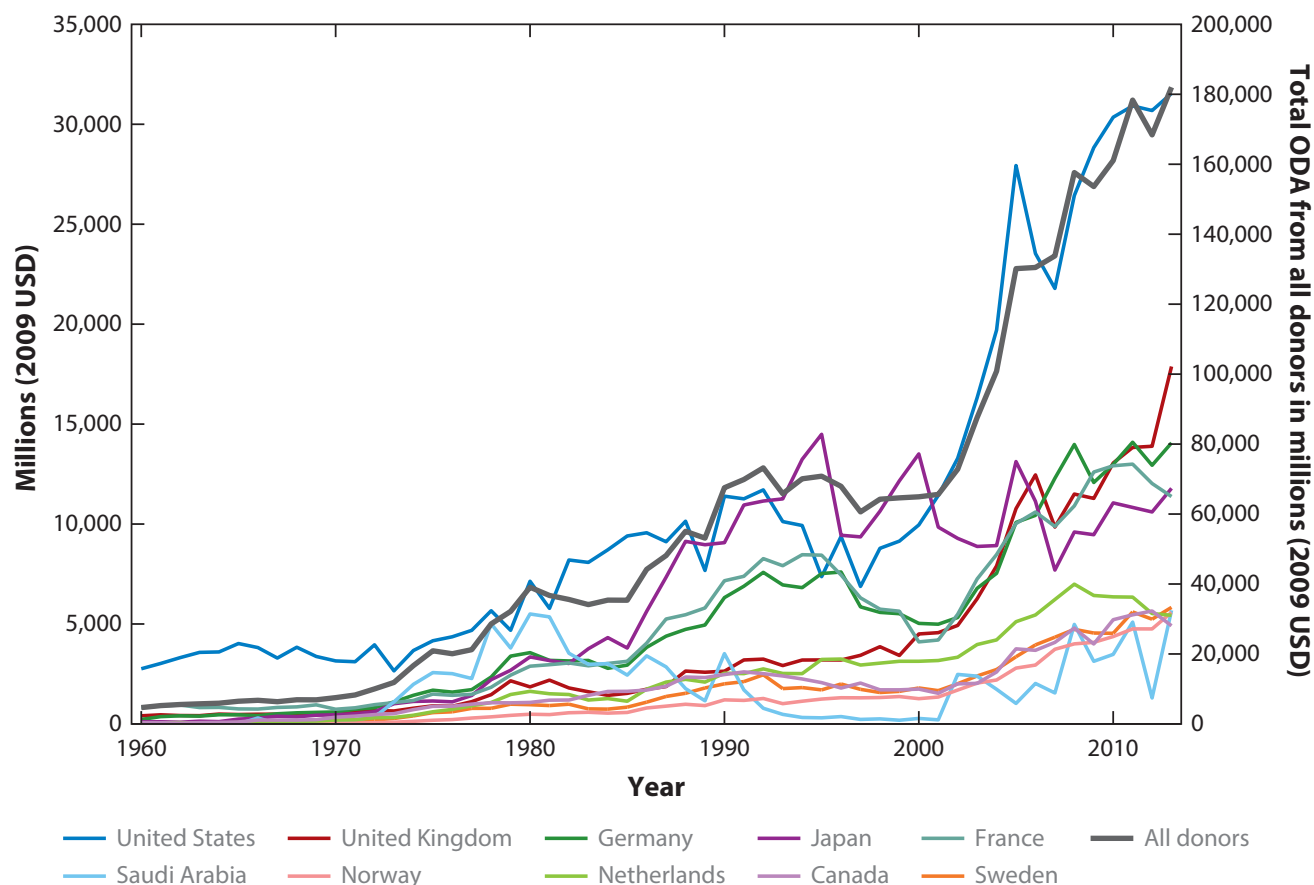


Figure 1

Total official development assistance (ODA) and ODA from the top 10 donors, 1960–2013. A top donor is defined according to ODA disbursement in 2013. Data taken from OECD table DAC 1, flows by donor/QWIDS.

Past Trends in Aid: Who Receives?

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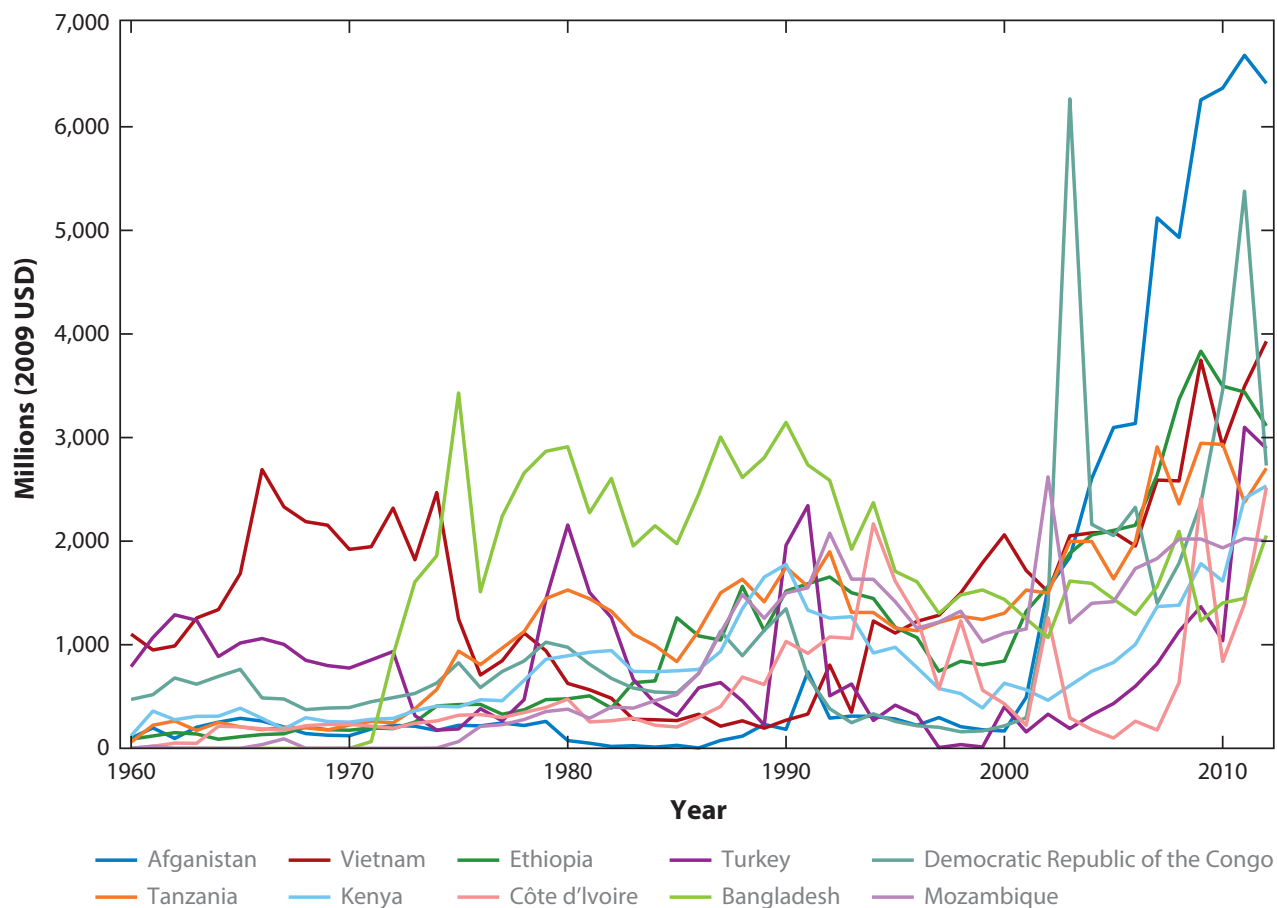


Figure 2

Official development assistance (ODA) received over the period 1960–2013 by the top 10 recipients in 2013. A top recipient is defined according to ODA disbursement in 2013. Data taken from OECD table DAC 2, flows by recipient/QWIDS.

Research on Correlations (Rajan and Subramanian 2008)

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TABLE 2.—IMPACT OF TOTAL AID ON GROWTH, OLS ESTIMATIONS
(DEPENDENT VARIABLE IS AVERAGE ANNUAL GROWTH OF PER CAPITA GDP)

	(1) 1960–2000	(2) 1970–2000	(3) 1980–2000	(4) 1990–2000
Aid/GDP	–0.063 (0.028)**	–0.076 (0.043)*	–0.120 (0.069)*	–0.008 (0.048)
Initial per cap. GDP	–1.332 (0.284)***	–1.668 (0.317)***	–1.632 (0.376)***	–1.147 (0.559)**
Initial level of policy (Sachs-Warner)	1.788 (0.431)***	2.278 (0.472)***	2.303 (0.773)***	–0.159 (0.551)
Initial level of life expectancy	0.024 (0.020)	0.016 (0.030)	0.063 (0.041)	0.151 (0.063)**
Geography	0.346 (0.132)**	0.386 (0.179)**	0.505 (0.224)**	0.693 (0.408)*
Institutional quality	3.944 (1.490)**	4.023 (2.223)*	1.361 (2.281)	2.951 (3.146)
Initial inflation	–0.003 (0.002)	–0.004 (0.003)	–0.001 (0.002)	–0.001 (0.000)***
Initial M2/GDP	0.017 (0.010)	0.016 (0.015)	–0.010 (0.023)	–0.003 (0.014)
Initial budget balance/GDP	–0.007 (0.024)	–0.014 (0.033)	–0.023 (0.035)	0.205 (0.059)***
Revolutions	–1.261 (0.506)**	–1.310 (0.488)***	–0.669 (0.627)	–0.491 (0.652)
Ethnic fractionalization	–0.102 (0.448)	–0.391 (0.704)	0.045 (0.903)	1.742 (1.084)
Observations	74	78	75	70
R-squared	0.77	0.70	0.64	0.63

All standard errors are robust and reported below coefficient estimates. ***, **, and * denote significance at 1%, 5%, and 10%, respectively. All specifications include dummies for sub-Saharan African and East Asian countries. For descriptions of the variables and their sources, see appendix A. The sample decreases for the 1980–2000 and 1990–2000 time periods because data on budget balance become sparser for the 1980s and 1990s, so the initial value of budget balance cannot be computed for these periods. Outliers are excluded based on the Hadi (1992) procedure on the core IV specification in table 4, which results in two countries being dropped from the 1980–2000 horizon in all the results that are presented.

Controversies

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- **Rich giving resources to the poor seems straightforward: Transfers of wealth to the poor should result in development in poor countries, right?**
 - ▣ Relieve credit constraints of governments $\Rightarrow$ Improved public services $\Rightarrow$ Improvements in infrastructure and human capital $\Rightarrow$ Growth
- **Worries**
 - ▣ Possible risk of Dutch disease (Aid increases exchange rates, makes imports cheaper, domestic industries that compete with international firms lose competitiveness)
 - ▣ Theory suggests possible risk to political instability
 - Increases returns to holding power, raises stakes over control of the govt. $\Rightarrow$ more conflict over power
 - More funds in the government $\Rightarrow$ more chance for corruption and abuse
 - ▣ General, anecdotal, sense that it hasn't been that effective
 - A lot of aid has gone from the rich to the poor countries over the last 50 years and many of those countries are still poor. Does it really work?

Which Story Dominates is an Empirical Question that is Hard to Study

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- **Does foreign aid affect growth and development and how much is hard to answer with correlational research:**
 - ▣ Reverse causality: More aid goes to the poorer countries $\Rightarrow$ negative correlation
 - ▣ Omitted variable bias: Aid is driven by various ties between countries that are hard to measure:
 - Political alliances
 - Business alliances
 - Diplomatic and military objectives of rich countries
 - Many others are plausible
- **Controversy on the literature**
 - ▣ See Qian (2015) in the syllabus pages 301-304
 - “The empirical literature on the impact of foreign aid is perhaps among the most controversial in development and growth economics.”

Some Recent(ish) Findings

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- **Rajan and Subramanian (2008):** No robust evidence for a relationship between aid and growth. Conclusion: aid system should be rethought.
- **Bitzer and Goren (2018):** Strong relationship between World Bank project and nearby economic activity (measured in night light luminosity).
- **Nunn and Qian (2014):** US food aid prolongs conflicts in sub-Saharan Africa
- **Rajan and Subramanian (2014):** Aid adversely affects competitiveness of domestic manufacturing

Huge Recent Policy Controversy

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□ Often taught as the “Sachs-Easterly Debate”

▣ Jeffrey Sachs (Columbia University)

- Argues for (much) more foreign aid in a “big push” to end poverty
- Supported by celebrities (Bono, Bob Geldof are prominent examples)
- Lays this out in his book *The End of Poverty: Economic Possibilities for Our Time* (2005)
- Tries to provide examples of this with the “Millennium Villages Project”

■ Further reading on the Mill. Villages and Sachs: *The Idealist* by Nina Munk

▣ William Easterly (The World Bank and NYU)

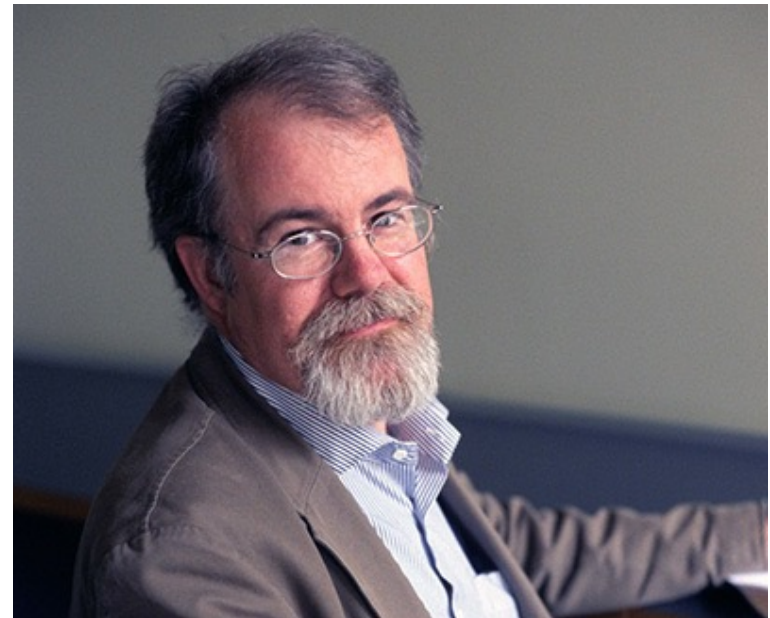
- Argues that foreign aid is a reinvention of colonial conceits and doesn't work. Highly critical of Sachs, Bono, Geldof and others
- Lays this out in his book *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done so Much Ill and So Little Good* (2007)

■ If that title doesn't make his view clear, he followed it up with *The Tyranny of the Experts: Economists, Dictators, and the Forgotten Rights of the Poor* (2014)

Huge Recent Policy Controversy

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- **These books are for popular audiences. They aren't academic work in economics**
 - ▣ Debate is partially due to the lack of clarity in the academic research over foreign aid's efficacy



More Recent Readings on the Effectiveness of Foreign Aid

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- **Danbisa Moyo's *Dead Aid: Why Aid is Not Working and How There is a Better Way for Africa* (2010)**
- **Abhijit Banerjee's and Esther Duflo's *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty* (2012)**

Backing Up/Shifting Gears

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- **You can think about foreign aid as a type of redistribution of wealth**
 - ▣ Let's ask a more basic and related question: Does redistribution help the poor at an individual level.
- **Weirdly, this basic question hasn't been studied very rigorously until relatively recently**
- **Focus of a large new literature on “cash transfer programs”**

Gertler et al.

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- **Research Question:** Do cash transfer programs have an effect on living standards? If so how much?

Background

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- **Two types of cash transfer programs:**
 - ▣ (1) Conditional
 - ▣ (2) Unconditional
- **Perhaps obvious and uninteresting:** Of course more money will help the poor, but...
- **Worry:** cash transfer programs are a temporary benefit and don't provide support for longer-term economic success

Policy Background 1/2

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- **Mexico establishes *Oportunidades* CCT in 1997**
 - ▣ Goal: Break intergenerational transmission of poverty
 - ▣ Provides cash to qualifying parents to invest in education for their children
 - ▣ Largest CCT interventions in the world
 - 5.8 “beneficiaries” in 2010
 - 4.5 billion USD distributed in 2010
- **Operates in rural areas and urban areas**
 - ▣ Rural areas are isolated, 50-2500 population, 89% engaged in farming, 7% have small business, 1.2% have formal credit institution

Policy Background 2/2

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□ Benefits:

- ▣ Cash given to female head of the household
- ▣ Conditional on children attending school and obtaining preventive medical care, and attending health-related seminars called *pláticas*
- ▣ 2 types of transfers:
 - (1) 90 pesos per month, received by all households if they get preventive medical care
 - (2) Education scholarships, only for households with children attending school $\geq 85\%$ of the time

Experimental Design

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□ Randomized Control Trial (RCT)

- *Oportunidades* phased into communities randomly in 1998 across 7 states
 - Treatment: 320 communities
 - Control 186 communities
- Data collected every 6 months through 2000 and then again in 2003

Measuring Investment

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□ 3 Primary measurements

- (1) Ownership of productive animals (cows, chickens, sheep, pigs rabbits) and draft animals (donkeys, mules, horses, oxen) (measured in total market value of animals owned)
- (2) Amount of land used by the household (measured in ha)
- (3) Participation in some small business activity (=1 if participates, =0 otherwise)

Model

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$$A_{ijt} = \alpha_0 + \alpha_1 T_{ij} + \underbrace{\sum_t \alpha_{2t} Wave_t}_{\text{FE for time}} + \underbrace{\sum_k \beta_k X_{ijk,97}}_{\text{HH controls}} + \underbrace{\sum_l \gamma_l A_{ijl,97}}_{\text{Pre-cash transfer value of the outcome}} + \varepsilon_{ijt}$$


**This is
what we
care about**

FE for time
(controls for
shocks
associated
with year of
observation
common to
all
observations)

HH controls

**Pre-cash
transfer
value of the
outcome**

OLS Results

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TABLE 2— OPORTUNIDADES IMPACT ON AGRICULTURAL ASSETS

	Draft animal ownership = 1 (OLS) (1)	Production animal ownership = 1 (OLS) (2)	Land use = 1 (OLS) (3)	Value of draft animals (in pesos) (OLS) (4)	Value of production animals (in pesos) (OLS) (5)	Number of hectares used (OLS) (6)
<i>Panel A. Sample: October 1998 to November 1999</i>						
A1. Unconditional sample ($N = 33,103$)						
Treatment = 1	0.042*** (0.014)	0.036** (0.015)	0.031 (0.019)	65.124** (25.291)	186.830*** (66.995)	0.062 (0.059)
Mean dependent variable (control households)	0.246	0.705	0.585	304.066	1,125.756	1.235
Probability same effect for all waves (p -value) ^a	0.929	0.375	0.632	0.125	0.103	0.749
A2. Conditional sample ^b						
Treatment = 1	0.026** (0.011)	0.056** (0.026)	0.050** (0.023)	104.947* (56.695)	208.420*** (73.479)	0.031 (0.087)
Observations	21,796	5,948	13,612	11,279	27,107	19,171
Mean dependent variable (control households)	0.107	0.453	0.327	741.923	1,279.164	1.802
Probability same effect for all waves (p -value) ^a	0.818	0.454	0.937	0.060	0.112	0.920

OLS Results

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TABLE 2— OPORTUNIDADES IMPACT ON AGRICULTURAL ASSETS

	Draft animal ownership = 1 (OLS) (1)	Production animal ownership = 1 (OLS) (2)	Land use = 1 (OLS) (3)	Value of draft animals (in pesos) (OLS) (4)	Value of production animals (in pesos) (OLS) (5)	Number of hectares used (OLS) (6)
<i>Panel B. Sample: November 2003</i>						
B1. Unconditional sample ($n = 10,244$)						
Treatment = 1	0.031 (0.020)	0.020 (0.018)	0.027 (0.017)	138.700** (64.847)	72.491 (86.687)	−0.039 (0.167)
Mean dependent variable (control households)	0.292	0.738	0.670	629.055	1,418.382	2.477
B2. Conditional sample ^b						
Treatment = 1	0.039* (0.019)	0.047 (0.035)	0.038 (0.027)	185.141* (111.156)	75.025 (97.832)	−0.282 (0.210)
Observations	6,725	1,772	4,108	3,511	8,460	5,939
Mean dependent variable (control households)	0.152	0.545	0.446	1,306.504	1,574.968	3.189

OLS Results

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TABLE 3—OPORTUNIDADES IMPACT ON MICROENTERPRISE ACTIVITY

	Micro enterprise = 1 (OLS)	Handcrafts = 1 (OLS)	Carpentry and construction = 1 (OLS)	Sewing clothes = 1 (OLS)	Making food for sale = 1 (OLS)	Repair artifacts or machinery = 1 (OLS)	Other activities = 1 (OLS)
<i>Sample: October 1998 to November 1999 (N = 33,103)</i>							
Treatment = 1	0.033** (0.015)	0.029** (0.012)	−0.002 (0.004)	0.000 (0.001)	0.001 (0.001)	−0.000 (0.000)	0.007* (0.004)
Mean dependent variable (Control households)	0.049	0.016	0.007	0.006	0.003	0.000	0.017
Probability same effect for all waves (<i>p</i> -value) ^a	0.800	0.494	0.833	0.761	0.244	0.845	0.551

OLS Results

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TABLE 4— OPORTUNIDADES IMPACT ON AGRICULTURAL INCOME, AGRICULTURAL PRODUCTION, AND CREDIT

	Total agricultural income A ^a (OLS)	Total agricultural income B ^a (OLS)	Produce corn = 1 (OLS)	Produce beans = 1 (OLS)	Animal products sold = 1 (OLS)	Productive loans = 1 (OLS)
<i>Sample: October 1998 and May 1999</i>						
Treatment = 1	2.358** (1.150)	2.808* (1.635)	0.023 (0.021)	0.020* (0.012)	0.017* (0.009)	0.004** (0.002)
Observations	21,414	10,458	22,369	22,369	22,369	22,350
Mean dependent variable (Control households)	24.624	22.980	0.476	0.079	0.120	0.006
Standard deviation dependent variable (Control households)	28.763	28.214	0.499	0.269	0.325	0.080

OLS Results

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TABLE 5—LONG-TERM CONSUMPTION AND INCOME SOURCES

	Consumption (OLS) (1)	Home production (OLS) (2)	Oportunidades transfers (OLS) (3)	PROCAMPO transfers (OLS) (4)	Total private transfers (OLS) (5)	Amount borrowed (OLS) (6)	Outside wages (OLS) (7)
<i>Sample: November 2003</i>							
Original treatment household = 1	10.836** (4.832)	2.038* (1.091)	−1.724 (1.328)	0.153 (0.400)	−0.006 (0.340)	0.066 (0.138)	4.068 (6.215)
Observations	10,166	9,984	9,977	9,441	9,673	9,632	8,754
Mean dependent variable (control households)	193.715	12.398	49.448	4.575	3.213	1.070	154.411
Standard deviation dependent variable (control households)	118.345	22.531	30.794	11.781	20.344	9.637	134.508
Proportion dependent variable > 0	—	0.510	0.906	0.281	0.154	0.090	0.660

Methodological Worries

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□ Attrition:

- ▣ About 10% for the treated and control groups
- ▣ Authors argue this isn't a worry because attrition was similar across both groups
- ▣ Doesn't seem to be correlated with observable characteristics