Does development aid give development?

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See: http://www.martin.paldam.dk
PS: I have worked for UNDP, IBRD, IDB and a little for DANIDA and OECD Development +

I have spent 3 years in poor countries: 2 years in Nigeria + 1 year in Chile

Almost a year traveling in about 50 LDCs

Taught development in 40 years in and out.
A book + 10 papers on aid

  – Post-evaluation of 37 projects in 9 countries

• Papers in journals:
  – 3 primary studies of aid effectiveness
  – 7 meta-studies of the literature. With Chris Doucouliagos, who is a co-author of the textbook
Background 1: Development happens!

![Graph showing income growth over time with regions labeled: Africa (44), Others (73), West (20).](image)
Background 2: Denmark and the world

- Wealthy, and for so long that we have forgotten
- Democracy, and for so long that we have forgotten

- We are exceptional in other respects:
  - Very low Gini and very high taxes
  - Very low corruption and high trust
  - The average Dane trust the police, the courts and (even) the politicians.

- This makes it difficult, when we meet the world
Meeting the world – are we babes in the wood?

- Solutions that work in Denmark not everywhere else?

- Collecting taxes: Not easy. In Africa: 10-20%

- Think of minister XX in poor country Y. He got into power by supporting president Z. If Z is toppled he may have to flee. And then he gets no pension.

- He is charming and willing to say a lot of nice things about good governance,

- but he really needs a few millions in a Swiss bank
Some facts about aid: Data from OECD-DAC

ODA: Official development aid: Gifts + cheap loans, i.e., loans that are 25% cheaper than market prices

PS: Debt forgiven is included. Most (?) loans to LICs are forgiven. Tricky game!

- Development aid: ODA 2013 US$ 134.8 bil
- Aid from China, India, Arab Oil countries another US$ 40 bil (?)
- Almost as the GDP of Denmark: US$ 240 bil.
- It is almost 10% of the GDP of the recipients and 0.4% of the GDP of the rich countries.
Goal of development aid

• Original: Development. Aid up ➔ faster development

• Operationalization: Aid-share of GDP, and the real growth rate

• Problem: Correlation of aid share and growth is zero
• This is chocking, but easy to check – next two slides
• It is well-known to insiders, but in the aid industry it is not mentioned
5-year average for ODA/GDP and growth per capita
Data for aid recipients.

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Over time Africa – any correlation?
Terrible results: What to do?

• Make more complex and softer goals
  – everything less clear

• Make complex models
  – Find the ‘right’ model that shows what we want to see

• How: Put structure on data by controls for country differences and estimators correcting for reverse causality. We can!
More goals:

• Old politics: Development allows countries to solve their problems. Close to colonial area, we did not want to be neo-colonialists.

• New politics: We want poverty reduction/inequality reduction

• Poverty: % of pop living for under 1, 2 $ a day

• Income distribution: Gini see next slide

• Denmark 0.25, EU 0.25-0.32, USA 0.32-0.40, India do, Africa 0.45-0.50
Indkomstfordelingen: Mange mål – vi ser på Gini

Gini = Areal mellem sort midterlinje og landet linje i %

- 0,22
- 0,33
- 0,52

Andel af indkomster

Fattigste

Andel i %

Rigeste
Politics and policy logic:

- PS: relation between growth and equality weak, so maybe independent: So independent goals as well.

- Growth with same Gini $\Rightarrow$ poverty down (doable?)
- No growth, Gini down $\Rightarrow$ poverty down (difficult)

- PS: In long run Growth $\Rightarrow$ Gini down
- Miracle cures Gini down quickly $\Rightarrow$ economic chaos
- Cases: Sandinistas, Allende, Garcia, etc.
- PS: Denmark It took more than 100 years
Also goals:

- Good governance: no suppression, democracy, low corruption …
- Grand UN-conferences ➞ always nice resolutions
- Problem: Many countries vote for. Few take them seriously.
- Donors often demand these high goals.
- The Arab initiative: Help good governance
- Effect?? Not clear goals, not easy to see effect
Many soft goals

• Also: In donors important to build coalition ➔ many NGOs get projects for their goal
• So goals proliferate.
• Economists has built an analytical technique for projects: Before project: feasibility study
• After: Completion report
  – Calculate (expected) costs and benefits of project
  – Use a discount factor (like an interest rate) to get everything to the data of decision
  – Make no sense even with three goals
Also, what does recipients accept?

• Case corruption: All countries are, in principle, against, but many politicians take bribes, either for themselves or their party.

• So have an anti-corruption committee, but it knows that it has to be careful: Maybe it can indict A, but not B.

• Think back minister XX in poor country Y. He is a client of president Z. If Z is toppled he has to flee + gets no pension. So he speaks nicely about the anti-corruption committee, but he do not want it to be effective.

• 5 papers on aid and corruption: Very few results!
Democracy and aid

• We have democracy indices, measuring the degree of democracy. Policy: +10 for Denmark, -10 for Saudi Arabia

• The indices are nor wonderful, but an effort is made

• Make model: $D = F(a)$

• About 10 papers: A weak effect $D \Rightarrow a$, but not $a \Rightarrow D$
The big question to aid to improve institutions to give good governance

• Do LDCs want us foreigners to reform their institutions ????
• Do LDCs want us to interfere in their politics, in the gender policies, their … ??
• Do LDCs want us to preach moral to them ?

• Make reverse test: Would we like foreign states to come here and improve our democracy, our gender roles etc.
But (almost) everybody likes development

- So we are back to the old goal:
- Development aid is to give development

- Special stories on disaster relief
- Food aid and military aid

- You remember the awful zero-correlation result:
- P.t. about 200 papers studying the relation.
  It must be possible to find a better result:
Put Structure on model

Estimate: \( g = f(a) \). Effect is \( b = \partial g / \partial a \)

- **Causality**: Wanted: (1) \( a \rightarrow g \) but perhaps (2) \( g \rightarrow a \)
- If (2) strong it gives a bias in (1)
- Estimation techniques to sort (1) and (2) out
- PS: techniques are tricky, but no effect in general

- **Control** for country differences
- \( g = f(a) + f_2(b, c, d, e) \), where \( b, c, d \) and \( e \) are country characteristics
- About 60 have been tried. Typically 5 in the estimate.
Examples: Control for past growth, for political stability, for high inflation, for region of world
Data-mining problem

• The controls are often related, and hence, if you pile them on the estimate collapses. So typically only about 8 controls in model.

• 8 can be chosen from 60 in $26,000,000,000$ ways. Each gives an estimate.

• The $26 \times 10^9$ estimates are distributed around 0. So half the estimates are positive, of these 5% are significant at 5% level. Are the model robust!?

• It takes 30 seconds to run a regression, so 60 per hour.

• Easy to choose models that tell the story you want. But it has proved difficult to tell a story that survives independent replication.
A look at the literature 1770 published estimates

The graph illustrates the correlation between estimates and publication years. The x-axis represents estimates in order of publication year, while the y-axis shows partial correlations. The plot is divided into two main periods: Period (1) and Period (2), with further subdivisions into Sub-period (A) and Sub-period (B) for each. The data points suggest a trend with a gradual decrease in partial correlations over time.
What do people want to find?

- Publication bias: Defined as a systematic difference between the true results and the published one. 2,960,000 hits in Google scholar
- Sponsor interests: Defined as the effect of a sponsor on the results (not in a crude way). 293,000 hits in Google scholar
- Expect such biases in aid effectiveness research both idealism and interests
Idealism: find aid works

find aid fails
Sponsors: find aid works

find aid fails
A case to consider

• From the figure on slide 21. The first 1300 estimates showed a near linear downward trend. This is the studies from 1970 to 2008

• This is unlearning by doing. Not possible

• Not a fact but and artefact

• The data sample grow very fast: In 1970 small sample, then data grow and the variation in results fall

• If researchers select large estimates, they get smaller over time

• Thus, it looks as if estimates fall, but it is bias that falls
Meta-analysis has tests for publication bias

• This is technical so not today
• Seven papers with Chris Doucouliagos, who is the co-author of the textbook in meta-analysis.
• When the tests are applied:
  • The average is 0.06, and half is a bias.
    The true effect is 0.03 – it is very small
• With 1770 estimates this is significant
• Since 2009 estimates go up, but it is the bias that go up
• Also, authors who work for aid find bigger effects
Why is the effect so small? It is strange

- Back to cost-benefit analysis
- Benefits are contribution to development. A technique has been found
- Costs are costs – that is easy
- Feasibility study: expected benefits and costs calculated to decision time by discount rate
- After: An project evaluation: same technique

- Think of a discount rate of 10%
Feasibility studies 10% +

• Evaluations: Half fail (did not reach 10%), half successful (did exceed 10%)
• So average project a little less than 10% say 8%
• Aid 10% of GDP in recipient countries:
• With rate of return 8% this should give 0.8% growth. Maybe less as some projects serve non-economic goals, such as political or cultural.

• Imagine 0.6%, average growth of 1.5% This is more 1/3. it should be very easy to find, but we can not?
PS: since the rate of return is about 8%
The problem is not at the project level

It is an negative externality:
It is something that is harmful to everything else
Big mystery: This has generated the literature

• Reasons why the effect is missing
• Some say: Aid disappear in corruption, …
• This is true if the corruption is money hidden abroad. Else it is redistribution, which may not harm growth
• The World Bank/UNODC Stolen Asset Recovery Initiative assesses (in 2012):
  • ‘Developing countries lose between $ 20 billion and $ 40 billion each year to bribery, embezzlement, and other corrupt practices.
• Most of these loses are not from aid flows! So at most 10 bil of the 170 bil. Not the explanation
PS: my book about projects

• 37 randomly selected projects in 9 countries
• Success rate about 50% only 1 harmful

• Corruption was a problem for 2-3 projects
• But only small problem. An extra cost
Five arguments

Fungibility

Dutch Disease

Executive capacity

Preferences conflicts

Aid ➔ public sector to rise in unsustainable way
(The Rolls Royce gift)
Fungibility

• The aid project frees funds to other projects
• That is aid finances a fine project, but causes a marginal project
• The aid project is fine
• But the marginal project is not

• New Mercedes Benz’ès to ministers and permanent secretaries. Is it a high priority project???
• Maybe the dealer will give a nice kickback
Dutch disease
Exchange inflow $\Rightarrow$ exchange rate revaluation
Famous case in the Netherlands when much gas was found
So it looks good but harms export

• So if aid helps public sector and harms export
• Not so good in the long run

• At least not so good as it looks in the short run
• PS: Dutch disease is nice to get in the short run
• But problematic in the long run
Executive capacity

- Countries are poor because they have no big executive capacity
- If they could, they would.
- Example: How long does it take to teach a population to read? Denmark UPE 1801 (1820?) everybody reads 1880?
- 3 years of UPE? But who can teach
- When the kids are out of school nothing to read
- Reading is gone in five years, so libraries …
- 2-5 generations.
An effective civil service

- Good bookkeeping, filing systems, etc.
- British + French, but left …
- First down so up

- Limited capacity
- Aid projects demand much → other projects suffer

- Like: Big projects to fight aids – rest of health sector shrinks.
Preference conflicts

• We know what they need + have the money we know we have to listen, but we are development experts!
• They want projects so they say what they believe we want to hear.
• This has been said a million times, but difficult in practice.
• Will they maintain a road we have decided they need?
• Chinese solution: They say what they want. The Chinese say yes or no.
The Rolls Royce problem

• If you got a Rolls Royce as a gift
• And you could not sell it, because the donor keeps an eye on you
• Lovely car till you need fill the tank and something breaks

• There are some such cases, but not many
Second last two points:

- From projects to sector programs
- And from sector programs to budget support

- Easier to give and not so easy to evaluate
- Does it work better???
Last point: What works?

• Last 50 years from 20 to 50 DCs
• What did the new 30 countries do?
• We know they found some goods they could produce and sell. It works – we also did!

• Long run: find some goods you can sell
• Most LDCs have small economies
• Zambia is as Aarhus county (not region)
• Essential to specialize and export