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Does Aid Contribute to Economic Development?



UNU-WIDER and research on foreign aid

- Point of departure: aid is diverse and complex – no single individual can encompass it all
-  ReCom - A large and comprehensive, joint research, documentation and communications initiative (initiated in early 2011)
- See <http://recom.wider.unu.edu/>
- See also <http://www.ullandsnyt.dk/blog/374/startede-med-nysgerrig-minister>

Four key questions

Motivated by desire to understand better four key questions about aid:

- What works?
- What could work?
- What is scalable?
- What is transferrable?

Where to begin?

- **Our choice: the macro aid and growth literature**
- **Somehow elusive**
 - Many critical voices
- **They often frame and strongly influence the development debate and there is frequently talk of a micro-macro paradox? What do we mean by that?**
- **But is it true that the impact of aid “evaporates” as we move from the project (micro) level up to the macro economy? What can we say on balance?**

Why it is difficult?

- **Aside from ideological debates.....**
- **Data**
- **A thorny econometric challenge: attribution elusive**
 - More growth typically associated with less aid
 - Causality not so easy to establish – how to do it is far from simple? The need to use statistical methods.

Why it is difficult? (cont.)

- A key point: what does lack of statistical significance mean?
- “Absence of evidence” vs “evidence of absence”
- Just because economists have had a hard time at the macro level does not in and by itself prove aid impact is not there
- And time has been passing and the macro-evidence now piling up – and, yes we can say quite a lot – based on WIDER research

Key macro questions and answers

Q. Why are some countries poor?

A. Poor countries produce very little.

Q. Why do poor countries produce so little?

A. Poor countries employ rudimentary technology, possess limited stocks of human and physical capital, and have poorly functioning institutional structures.

Q. Why do poor countries lack the wherewithal to produce?

A. Poor countries have not managed to accumulate over time.

**Growth is a long run and fragile process of accumulation.
What does this mean for the analysis of aid and growth?**



**The aggregate impact of aid:
what can we say on balance?**



First conclusion: based on cross-country data (*Journal of Globalization and Development*)

- **On average and in the long run, aggregate aid contributes positively to growth at levels predicted by growth theory – aid has been associated with a growth bonus.**
- **So, there is no micro-macro paradox.**

Second conclusion: based on time-series data (*Oxford Bulletin of Economics and Statistics*)

- **Aid has a positive long-run effect on key macro-variables (GDP, investment, consumption) for the vast majority of countries**
- **In only 3 out of 36 countries is there a negative effect of aid on GDP or investment**
- **The transmission of aid on the macro economy quite heterogeneous. Hence a country-specific approach is vital**

Third conclusion: unpacking the aggregate effect (*World Development*)

- Consistent and coherent pattern of results across meso- and macro-outcomes
- Cumulative (long-run) impact of aid, NO quick wins
- Internal rate of return from aid (to growth) = 16%
- Ambiguous link from education to growth as found elsewhere
 - Remember: positive impact of aid on education
- Aid supports key building-blocks for growth:
 - physical investment
 - human capital (health)

Fourth conclusion: meta-work (*Journal of Development Studies*)

- **Paldam and colleagues ignore heterogeneity: problematic for theoretical reasons**
 - They simply mis-measure the partial effect of aid for those papers which include an interaction term with the aim of capturing the non-linearity in the aid - growth relation
- **The assumption of heterogeneity in the true effect of aid on growth across studies is confirmed.**
 - Statistical tests + graphical tools
- **Controlling for heterogeneity, the weighted average effect of aid on growth is found to be positive & statistically significant**

Overall conclusions

- Evidence on aid's growth and development impact mounting
- ReCom has produced a coherent set of evidence
- The need to move beyond growth – the development agenda post-2015
- Other activities
 - UNU-WIDER project on growth, poverty and inequality (September)
 - L2C – with Brookings and AfDB (June)
 - <http://www.wider.unu.edu/>
- Looking to the next 5 WIDER years