Programming for Growth: The Economic Impact of Foreign Aid

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Overview

- Focus on programming “for growth”
- Controversy on aid effectiveness
- Measuring effectiveness
- Evidence from USAID’s EG programs
- Policy implications
Programming for Growth

• Growth as a goal of U.S. foreign assistance policy
  — From Marshall Plan to 2010 Presidential Policy Directive on Global Development
  — G20: Seoul Development Consensus

• Growth as a central engine for poverty reduction

• Growth as a foundation for sustainable gains in health, education, food security, opportunity, choice

• Growth as an instrument to reduce conflict risk

• And yet, lack of constituency for EG programs
GDP per capita in Zambia and Indonesia
1970 - 2008 (constant 2000 US$)

Source: World Development Indicators. Income is measured in terms of Gross Domestic Product.
Higher income, less poverty

Poverty and Per Capita Income in Developing Countries, 2005

Source: World Development Indicators, 2010 and author’s calculations
Non-income measures

Girls Average Secondary Enrollment

- Low Income: 36.3
- Lower Middle Income: 73.4
- Upper Middle Income: 91.0

2005

Average Infant Mortality Rate (per 1,000 live birth)

- Low Income: 78.3
- Lower Middle Income: 35.1
- Upper Middle Income: 17.7

2005

Source: World Development Indicators, 2010
Faster Growth, Faster Poverty Reduction

Per Capita GDP Growth and Extent of Poverty Reduction Between Household Surveys 1985-2005

Source: World Development Indicators, 2010 and author’s estimates.
Funding for EG Programs

Funding by Program Area, % Total Foreign Assistance

<table>
<thead>
<tr>
<th>Program Area</th>
<th>2009 Percentage</th>
<th>2010 Percentage</th>
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</thead>
<tbody>
<tr>
<td>Peace and Security</td>
<td>29.3</td>
<td>28.0</td>
</tr>
<tr>
<td>Governing Justly and Democratically</td>
<td>8.3</td>
<td>8.2</td>
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<tr>
<td>Investing in People</td>
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<td>Economic Growth</td>
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<tr>
<td>Humanitarian Assistance</td>
<td>14.9</td>
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<tr>
<td>Program Support</td>
<td>3.9</td>
<td>5.4</td>
</tr>
</tbody>
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What are “EG” programs?

Funding by EG Program Area, FY2010

- Macroeconomic foundation: 5.6%
- Trade and investment: 5.7%
- Financial sector: 2.5%
- Infrastructure: 15.8%
- Agriculture: 32.5%
- Private sector competitiveness: 14.0%
- Economic opportunity: 5.4%
- Environment: 18.5%
Money down a rat hole?

- Decades of controversy
  - Peter Bauer, Jesse Helms … Dambisa Moyo
  - William Easterly vs. Jeffrey Sachs
  - “Randomista” revolution: Esther Duflo, Abhijit Banerjee
  - Debate on income growth as metric for well being
  - Public opinion on aid

- Decades of inclusive econometric analysis
  - Absence of robust findings
  - Causality problems
  - Measurement of “aid”
  - \( H_0 : \frac{\partial gY}{\partial (A/Y)} = 0 \)? Or perhaps 0.1??
How to spur economic growth?

• Conclusion from a half century of development experience & piles of studies:
  — No simple recipe for growth
  — Strategies must be tailored to country conditions

• But we do have a broad understanding of obstacles and principles for success
  — Committed, capable leadership
  — Global linkages
  — Macroeconomic stability
  — Saving and investment
  — Market allocations
Economic Freedom and Growth

Index levels range from 0 to 100 ("repressed" to "free")

Average change in Economic Freedom Score, 1995-2005

- Avg. pci growth rate (95-05) < 1
- 1 <= Avg. pci growth rate (95-05) <= 3
- Avg. pci growth rate (95-05) > 3
Gauging Aid Effectiveness

- 2005 Paris Declaration on Aid Effectiveness
- Performance evaluation
- Impact evaluation
  - Compare outcomes to a counterfactual
- *Economic* impact evaluation
  - Valuation of benefits vs. costs
  - Economic rate of return as standard metric
- Rigorous methods rarely used by USAID
  - Often difficult to implement for EG programs
The official report

- Annual Foreign Operations Performance Report, 2009 (latest)
- EG program results
  — 12 “representative” indicators
  — Examples
    o Macroeconomic foundations: Fiscal deficit
    o Financial sector: Credit to the private sector
    o Private sector competitiveness: Commercial laws
  — No serious information here on EG program effectiveness or return on investment of aid $$$
1. Economic impact of EG programs can be huge
2. Intermediate results can be compelling
3. Long-term benefits can be dramatic
Economic impact can be huge

- Measured as return on investment of aid $$$
- Private sector development
  - e.g., Armenia: ISP monopoly pricing
- Business environment
  - e.g., Georgia: Customs facilitation
- Trade and Investment
  - e.g., Mozambique: Foreign exchange regulation
- Fiscal reform
  - e.g., Bosnia-Herzegovina: Tax administration
Note on methodology

• These findings are not based on randomized trials or quasi-experimental analysis

• Pragmatic “third-best” field methodology
  — Identify program benefits that are
    – Quantifiable, relative to a plausible counterfactual
    – Attributable, with high degree of confidence
    – Unavoidable mix of measurement and judgment
  — Examples
    – Georgia customs
    – Mozambique foreign exchange regulation
Intermediate Results can be compelling

- Private sector development
  - e.g. Ghana (agriculture inputs)
- Business environment reform
  - e.g. Philippines (telcom regulation)
- Financial sector reform
  - e.g. Jordan (capital market)
- In some qualitative results are compelling
  - e.g. Investor Roadmaps, South Africa (Mandela Economic Scholars)
Long-term benefits can be dramatic

- Building capacity for policy management
  - *e.g.* Korea, Indonesia
- Promoting trade and investment
  - *e.g.* Vietnam (legal reform)
- Financial sector reforms
  - *e.g.* Kazakhstan (capital market)
- Private Sector Development
  - *e.g.* Peru (green asparagus)
How representative are these examples?

- We don’t know
- Need more systematic evidence
  — MCC as world leader
  — New USAID Evaluation Policy, January 2011
  — World Bank’s Independent Evaluation Group
- But let’s also recognize practical difficulties
Conclusions

- **EG programs are critical for development success**
  - Including poverty reduction, social welfare, human development, food security, conflict risk reduction
  - For poorest countries, “no aid” option defies arithmetic

- **Evaluation systems have been highly deficient**
  - Need stronger evaluation procedures
  - Don’t look to cross-country econometrics for answers

- **But available evidence indicates that EG programs often do work**
  - Target catalytic “game changers”