Aid to Africa and the Changing Context
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Overview

• Introduction
• Aid, growth and development: what do we know?
• The changing global context: challenges and opportunities for aid
• Conclusions – a post 2015 perspective
Introduce recent WIDER research on foreign aid

• ReCom: A comprehensive research, documentation and communications initiative (initiated in early 2011)

– Motivated by our desire to understand better four key questions about aid:
  • What works?
  • What could work?
  • What is scalable?
  • What is transferrable?
Point of departure

• Aid is diverse and complex
  – no single individual can encompass it all => rely on global network of researchers and policy practitioners

• A sizeable research output now available under 5 core themes (incl. 200 WIDER WPs)
  – see http://recom.wider.unu.edu/

• We have drawn on this in preparing our paper
Aid, growth and development: what do we know?
Where to begin?

- The macro aid and growth literature, probably the most controversial theme
- 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?
  - Aid and macroeconomics
  - Aid, political economy and institutions
- 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 about aid’s aggregate impact?
It is difficult!

• Aside from ideological debates…..
• A thorny econometric challenge: attribution somewhat elusive
  – Progress typically associated with less aid
  – Causality not so easy to establish, so debate ripe with rhetoric:
    • Africa, aid, Africa still not developed…..
    • Anecdotes…..
  – We need a credible counterfactual (what would have happened without) -> we use statistical methods
Back to basics

• What does lack of statistical significance mean?
• Absence of evidence ≠ evidence of absence
• Just because economists have – over the years – 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 – 5 generations!
  – The macro-evidence has been piling up – and yes we can by now say quite a lot
• To a brief summary (skipping a lot)
From Rajan and Subramanian onwards

- Rajan and Subramanian
- 14 published papers post 2008 studying aid impact over the long run
  - 13 find positive effects (the outliner is ...)
  - Results suggest: a 10% increase in aid/GDP leads to 1% increase in rate of growth
  - Channels identified: investments in physical capital, health & education
- Overall, aid has had impact – IRR of 7.3% (without welfare weighting)
- Time horizon of analysis important
So...

- To the extent the existing aid system was designed at all, it was designed to improve the livelihoods of poor people in poor countries.
- Much has been achieved. Many countries (including former fragile states) have “graduated” and new donors have emerged (Republic of Korea).
- And looking beyond 2015: in 10 years 36 of 68 current IDA recipients will graduate out of IDA (CGD study)
  - Especially the large countries will graduate: India, Vietnam, Pakistan, Nigeria, Ghana and Kenya
  - Population in IDA eligible countries will fall from 3 to 1 billion)
- But success of course not always guaranteed: no sensible person.....
Africa and Globalization: Challenges and Opportunities
Risks of shocks

• **Trade Shocks**
  – Export markets have diversified: emerging economies 25% of Africa’s export
  – But 80% export revenue from commodities
  – And vulnerabilities to *global* shocks still exist

• **Financial Shocks**
  – Affect supply of trade finance

• **Do away with aid?**
  – In this environment?
  – Public versus private (FDI other) flows!
What about Dutch disease?

• Inevitable?
  – Not inevitable, depends on how aid is used
  – Infrastructure investment: reduces costs – export supply curve shifts to the right (Dutch vigour)
  – If aid deepens domestic financial markets: sterilization instruments become more effective
## The structural transformation challenge!

<table>
<thead>
<tr>
<th>Region</th>
<th>Labor productivity growth, %</th>
<th>Due to within sector productivity growth, %</th>
<th>Due to structural change, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>3.87</td>
<td>3.31</td>
<td>0.57</td>
</tr>
<tr>
<td>High Income</td>
<td>1.46</td>
<td>1.54</td>
<td>-0.09</td>
</tr>
<tr>
<td>LAC</td>
<td>1.35</td>
<td>2.24</td>
<td>-0.88</td>
</tr>
<tr>
<td>Africa</td>
<td>0.86</td>
<td>2.13</td>
<td>-1.27</td>
</tr>
</tbody>
</table>
So...

- Currently, in Africa labour moving from high productive sector (manufacturing) to low productivity activities
- Perverse structural change hampering productivity growth
- Happening in spite of MDG progress
- Donors must in particular recalibrate efforts towards:
  - Agriculture
  - New industrial policy
What can aid do – a few examples (1)

• Agriculture’s share: 6% of OECD-DAC aid in 2011 ($1.7 billion)
  – But 2/3 of population still relies on agriculture and critical for food security
  – Need increase in agric productivity & movement up the value chain
• So: aid can support rural transformation, i.e.
  – Small farm agriculture (seeds and much more)
  – Rural non farm enterprises/processing
  – Social protection policies that stabilize consumption
  – And infrastructure!!
What can aid do – a few examples (2)

• In industrial policy focus required on constrains that prevent enterprises from growing:
  o Capabilities
  o Credit
  o Energy
  o Transport, communications
  o Etc

• Attracting private investment: not just regulatory reform (e.g. “doing business” indicators)
What can aid do – a few examples (3)

• Aid can support regional integration
  – Inter country trade accounts for only 11% of Africa trade flows
  – Underinvestment in regional transport infrastructure characteristic and it prevents positive externalities from accruing to landlocked neighbours (these externalities are not internalized)
  – Unblock this
What can aid do – a few examples (4)

- Aid can help accelerate adaption to climate change in Africa?
  - Long-term planning and analysis required for adaption
  - Current stock of infrastructure requires maintenance (flooding etc)
  - Africa’s renewable energy resources untapped: high cost of financing capital for green energy suggests aid may have a supportive role
What can aid do – a few examples (5)

- Aid has an obvious role to play in fragile states
  - Reduce integration to global economy via bad ways: piracy, narcotics, human trafficking
  - Increase control over revenue (i.e., reduce corruption)
  - Encourage transparent fiscal process & inclusive growth
  - Programme support for state building required in addition to just project support
Looking post-2015
UN High-Level Panel report on the post-2015 development agenda

• Calls for:
  • “..A quantum leap forward in economic opportunities and a profound economic transformation to end extreme poverty and improve livelihoods...”
  • Arguably aid remains relevant to this endeavor
Accordingly…

- To remain relevant: aid must post-2015 deal with:
  - Increased complexity (on supply side)
  - The new geography of poverty (middle income countries)
- In addition to:
  - Helping preserve the gains made in peace & stability
  - Addressing challenges in a “hard core” of fragile states
- And help underpin ongoing efforts towards ensuring:
  - Transformation (agriculture and industry)
  - Inclusion
  - Sustainability