Lecture 20: Foreign Aid

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Today’s Plan

• Housekeeping
• Reading Quiz

• Today’s topic:
  • Foreign Aid
    • The Politics of Aid
    • The Economics of Aid
  • Also: Some highlights from current research in IPE
Housekeeping

- Paper topics for paper #2 are now posted
  - Due

- Extra Credit Opportunities:
  - Working in a Global Economy, Nov. 6, 5pm (RSVP required)
  - David Ben-David talk Nov. 12, 12-1:45 in WPH B27 at
2. Why would Sachs argue that developmental aid is just as important as military spending is to U.S. national security?

- a. the long-term benefits will outweigh short-term costs
- b. U.S. assistance for the world's poorest countries is adequate
- c. it will help strengthen fragile states
- d. a & c
- e. all of the above
Reading Quiz (2)

1. What is the Poverty Trap? It is when the poor lack the necessity(ies) of...
   - a. health
   - b. education
   - c. infrastructure
   - d. all of the above
The Big Question for Today

• What can (should) rich countries do to help reduce poverty in poor countries?
The Politics of Aid in the U.S.

• What percentage of U.S. government expenditures do you think we should spend on foreign aid?
  • A. Less than 1%
  • B. 2-3%
  • C. 5%
  • D. 10%
  • E. 25%
  • F. 50%
  • G. Greater than 50%
What percentage of U.S. government expenditures each year currently go to foreign aid?

A. Less than 1%
B. 2-3%
C. 5%
D. 10%
E. 25%
F. 50%
G. Greater than 50%
The US and Foreign Aid

% of budget that Americans...

- think we spend on foreign aid
- think we should spend on foreign aid
- actual amount we spend on foreign aid

% of budget

0.0 7.5 15.0 22.5 30.0

Picture from Felix Salmon
The US and Foreign Aid

ODA = Official Development Assistance

Net ODA 2010 as percent of GNI

Agreed Target: 0.7% of GNI

Source: OECD, April 2011
The US and Foreign Aid
Private philanthropy is a different matter...

For a little more discussion, see: [http://voices.washingtonpost.com/ezra-klein/2010/06/research_desk_responds_how_gen.html](http://voices.washingtonpost.com/ezra-klein/2010/06/research_desk_responds_how_gen.html)
The US and Foreign Aid

• From Facebook:

“Doesn't make much sense, does it??: Homeless go without eating. Elderly go without needed medicines. Mentally ill go without treatment. Troops go without proper equipment. Veterans go without benefits that were promised. Yet we donate billions to other countries before helping our own first. 1% will re-post and 99% won't. Have the guts to re-post this. I KNOW I'm in the 1%”

• Most Americans wouldn’t cut foreign aid in a “design your own budget” setup

• Compare 2012 Republican presidential candidates to George W. Bush
  • Recessions see a drop in support for foreign aid
The US and Foreign Aid

• Other concerns:
  • To what degree should US aid provision be strategic?
  • i.e. Why should the US aid countries that aren’t really our friends?
Goals when the U.S. Gives Aid

- 1. Promoting transformational economic development
- 2. Supporting strategic states
- 3. Strengthening fragile states
- 4. Providing humanitarian relief (e.g. natural disasters)
- 5. Addressing global challenges (e.g. HIV, climate change)
What do you think?

• Should the US reduce aid to countries that vote against US interests in the UN?
  A. Yes
  B. Sometimes, for important votes
  C. No
The Economics of Aid (the good)

• The goal:
  • Provide infrastructure
  • Provide education
  • Provide healthcare

• These increase human and physical capital
  • Raises wages and promotes growth
The Economics of Aid (the bad)

- Aid is dumping
  - Dumping = selling good for less than what they cost to produce
  - Banned because it drives local firms out of business
  - But giving away food, mosquito nets, medicine, and services can have this effect
The Economics of Aid (the bad)

• Imagine you run a private school
  • You serve the wealthiest 25% of kids in your area
  • Aid organization comes in and opens a free school
  • Puts your private school out of business
  • If the aid ever goes away, your community has no school
The Economics of Aid (the bad)

• Aid causes Dutch disease
  • Donors flood the local market with foreign currencies
Review question

• What is the negative effect of Dutch disease?
  • A. Imported goods get really expensive, hurting consumers
  • B. Local production becomes expensive, hurting exporters
  • C. Imported goods get really cheap, hurting local producers
  • D. Local wages fall, hurting workers
  • E. B & C
The Politics of Aid

• Poor countries are poor because they are poorly governed
• Two choices (rock and a hard place)
  • Deliver aid through governments
    • Give money to governments
    • Try to control how they spend it
  • Deliver aid around governments
    • Deliver services directly
Working Through Governments

• The good:
  • Respect sovereignty
  • Build government capacity and legitimacy

• The bad
  • Leads to corruption
  • Inefficient use of funds (waste)
Working Around Governments

• The good:
  • More efficient service delivery
  • Donor control of priorities

• The bad
  • Undermines government capacity
  • Undermines government accountability
The Sachs Argument

• We need a comprehensive plan and a big push
• With $200 billion a year, we can achieve “transformative development”
• Long-term planning and coordination are key
The Easterly Argument

- Big plans are the wrong approach for aid
- Needs to be locally driven, locally tailored
- Planning itself sucks up government resources
  - Makes governments serve the wrong masters
The Dambisa Moyo Argument

• Aid is bad for growth
  • Standard arguments about the faults of aid
  • Corruption, dumping and market distortions, dutch disease
• Also a resource-curse argument
  • Control of the central government gives access to aid $$, so motivates coups
• Negative stigma of aid dependence for investors
• Argues that “short, sharp, finite” aid can be good
  • Long-term, open-ended aid creates dependence
Poor Democracies, Trade Openness, and Revenue

- Paper by Nita Rudra
- When countries lower tariffs, they lose a source of revenue
  - Tariffs are easy to collect, other taxes are really hard
- Democracies have a harder time replacing that revenue
- Without revenue, government services decline
- This hurts the poorest individuals most

- In autocracies, trade openness tends to be better for the poorest individuals than in democracies