Africa Growth Initiative
at BROOKINGS

Aid and Growth: Have We Come Full Circle?

Monday, January 25th, 2010, 10:00 am — 11:30 am

The Brookings Institution, Stein Room, 1775 Massachusetts Ave, NW, Washington, DC

The debate between development aid and economic growth has been tilting in recent years, resulting in questions on aid effectiveness and a backlash against official development assistance policies, despite growing evidence of benefits at the micro level. New research by Channing Arndt, Sam Jones and Finn Tarp of the Development Economics Research Group at the University of Copenhagen, and in conjunction with UNU-WIDER, explore whether this debate has come full circle. Their latest contribution to the aid-growth debate seeks to answer the question," does foreign aid boost economic growth on average in developing countries?" On January 25th, the Africa Growth Initiative hosted an event at Brookings featuring presentations by the authors of the paper, as well as comments from David Roodman of the Center for Global Development and Homi Kharas of the Brookings Institution.

Professor Arndt began the presentation by discussing the relevance of the question at hand and whether it could be adequately addressed by economists. He argued that the most pressing empirical issues in this debate are mirrored on a number of important issues in economics, but that the question is too important for economists not to answer with their best methodologies. He did stress the necessity of focusing on the importance of the aid-growth debate while acknowledging both the complexity of the issue and the limitations with available data.

Professor Tarp provided a review of the literature over the last three decades, in which continually new methods have lended support to hypotheses on either side of the debate. Although some research has claimed to find no significant effect of aid on growth, there have been positive results at the micro and meso levels.

Sam Jones introduced the empirical approach of the paper, using insights from program evaluation that motivated three innovations: using a more robust estimator of aid, which uses observations weighted inversely by a country's propensity to receive aid; changing the specification to remove the redundant and over-controlling variables; and refining instrumentation, a technique used to demonstrate the causality of results, to better reflect the reality of foreign aid. In contrast to the past research, Jones showed that the effect of aid on growth is statistically significant. This result lends support to continuing foreign assistance, albeit with a renewed focus on improving its effectiveness.

After the presentations by the authors, the two discussants offered their comments on the results. David Roodman, a research fellow at the Center for Global Development, remarked on the contributions of the paper: a good awareness of the literature, a sense of humility of results, and carefully thought out specifications and empirical methods. He also offered several critiques, first cautioning against data mining, in which certain time periods are chosen to show specific results. Second, Roodman pointed out the fragility of such studies, as addition of new data or the removal of an outlier can nullify results. Third, he said that the causal instrumentation may be weak if it relies on the assumption that population effects growth only through its effect on aid. He also questioned whether their empirical technique was too simplistic by not accounting for variation of effects over time within countries. Finally, drawing on his background as a mathematician, Roodman argued for a general skepticism about regression-based approaches to aid questions, citing mathematical theorems that stress the inherent uncertainty and incompleteness of models.

Homi Kharas, a senior fellow at Brookings, also offered comments on the paper. He began by pointing to quotes from a number of distinguished economists, all of whom stressed the difficulty of determining what determines growth. He also argued that expectations for aid have been perhaps too high, given the share of assistance that actually goes toward investment. On this basis, he noted his appreciation for the paper's shifting of the null hypothesis for aid's impact, putting a more sensible burden of proof on the researcher. He did note some econometric issues with the paper, including the use of GDP adjusted for purchasing power, and the fact that averaging aid over time disguises its volatility, which is an important determinant of its effectiveness. Kharas also proposed some alternatives for thinking about aid's effectiveness, including large opinion surveys and observing private behavior of donors. Overall, Kharas lauded the comprehensive methodology and the humility of the findings, and hoped that this paper could help reset the expectations for aid.

As the discussion moved to question and answer, one attendee asked whether the model could account for the fact that much foreign aid is not directly targeted towards growth. The panel acknowledged that this was an important concern and one of the reasons why expectations for aid need to be managed, but that it is difficult to account for these issues. Ernest Aryeetey, Director of Africa Growth Initiative and moderator of the panel, then closed the discussion by noting that although the effects of aid on growth can be contentious, aid has certainly contributed to a better domestic policy environment in developing countries. This remark provided a fitting conclusion to an event in which the panelists favored nuanced and well-defended arguments over sweeping generalities regarding aid.