

ECO 330: Economics of Development

Jack Rossbach
Spring 2016

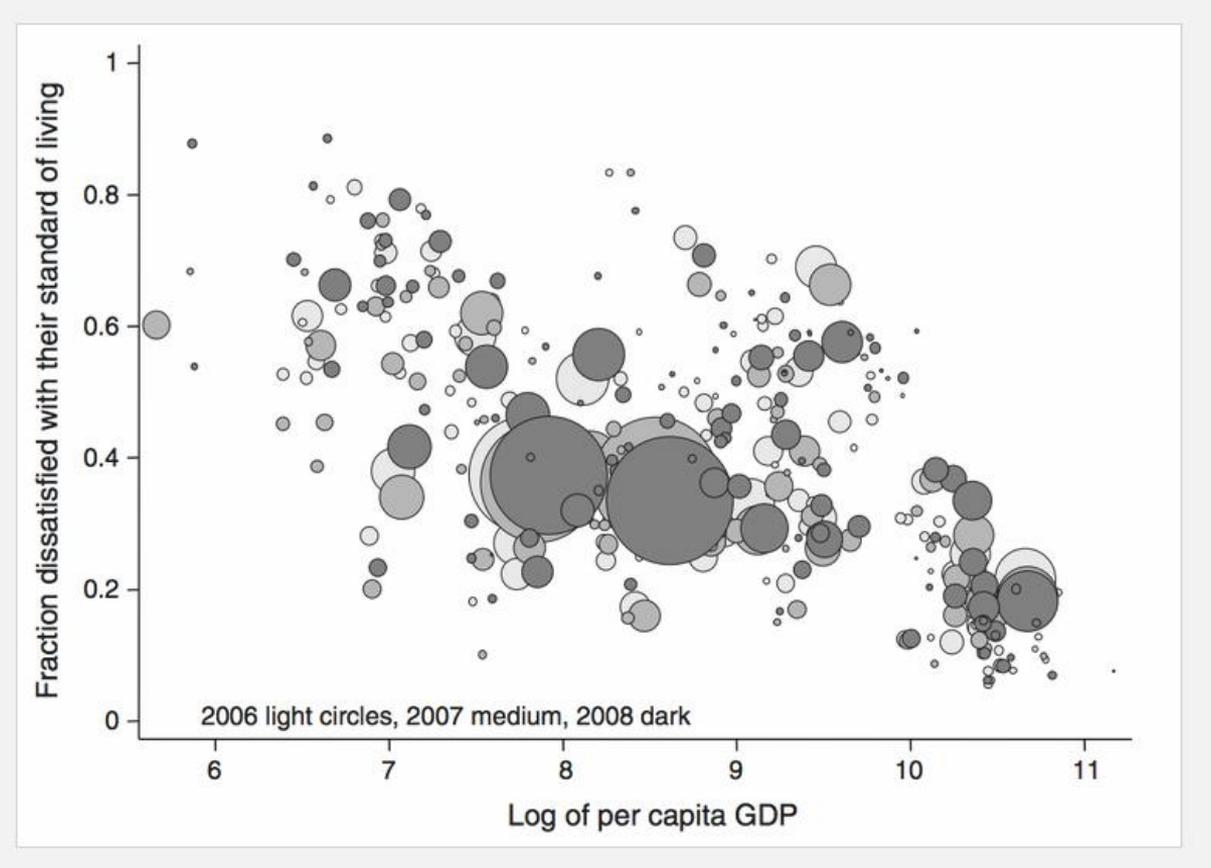
International Development

Recap of what we've learned over semester:

- There is a huge development gap between rich and poor countries
- Driven by **TFP**: a measure of both **efficiency** and **technology**.
- Institutions appear important for economic growth and reducing poverty

Question: Can rich countries help address the development gap through foreign aid?

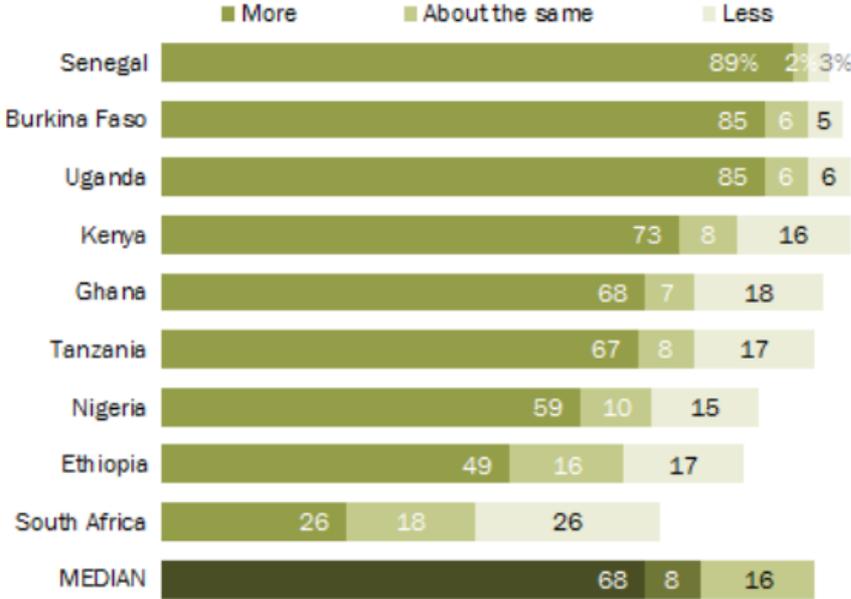
Do Developing Countries Want Foreign Aid?



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Most Say More Foreign Aid Needed

When it comes to foreign aid, do you think our country needs ___ than/as it gets now?

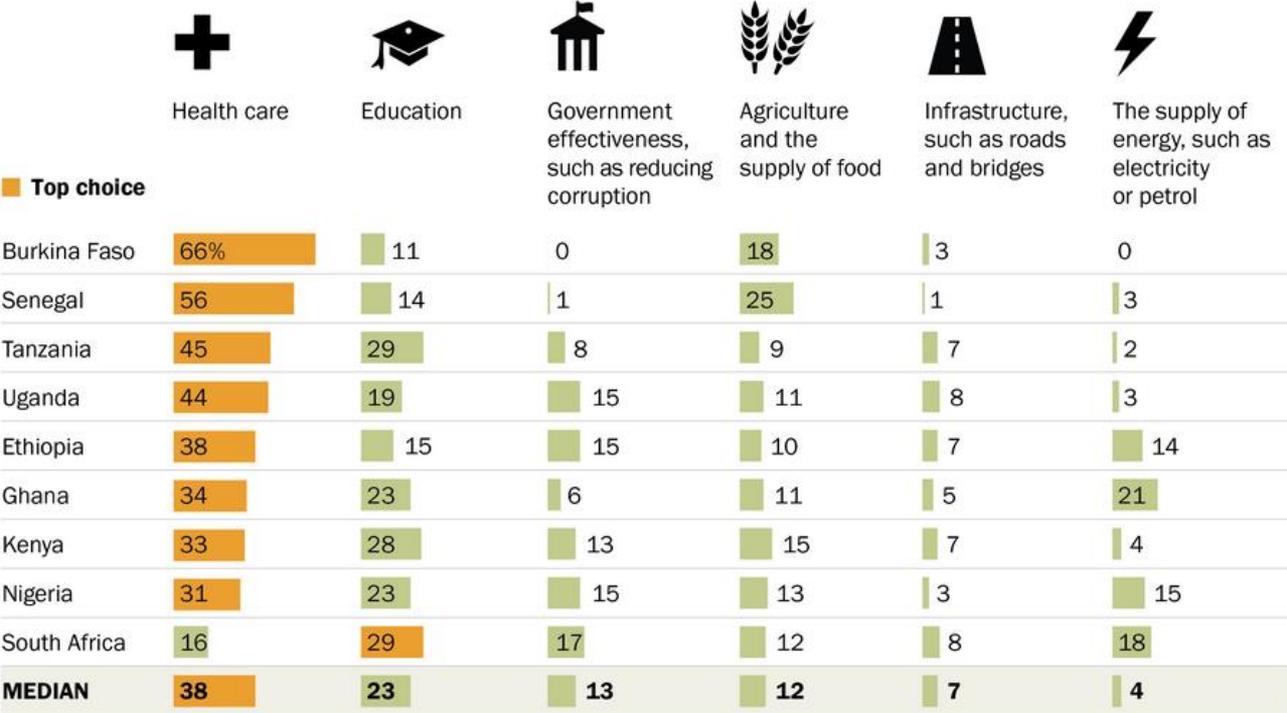


Note: Data for volunteer category "None" not shown.

Source: Spring 2015 Global Attitudes survey. Q123.

Do Developing Countries Want Foreign Aid?

What do you think should be the most important priority for our country?



Source: Spring 2015 Global Attitudes survey. Q66.

Foreign Aid

Often suggested that developing countries are poor due to poverty traps

- Evidence that these poverty traps exist
- Many people suggest they can escape with foreign aid

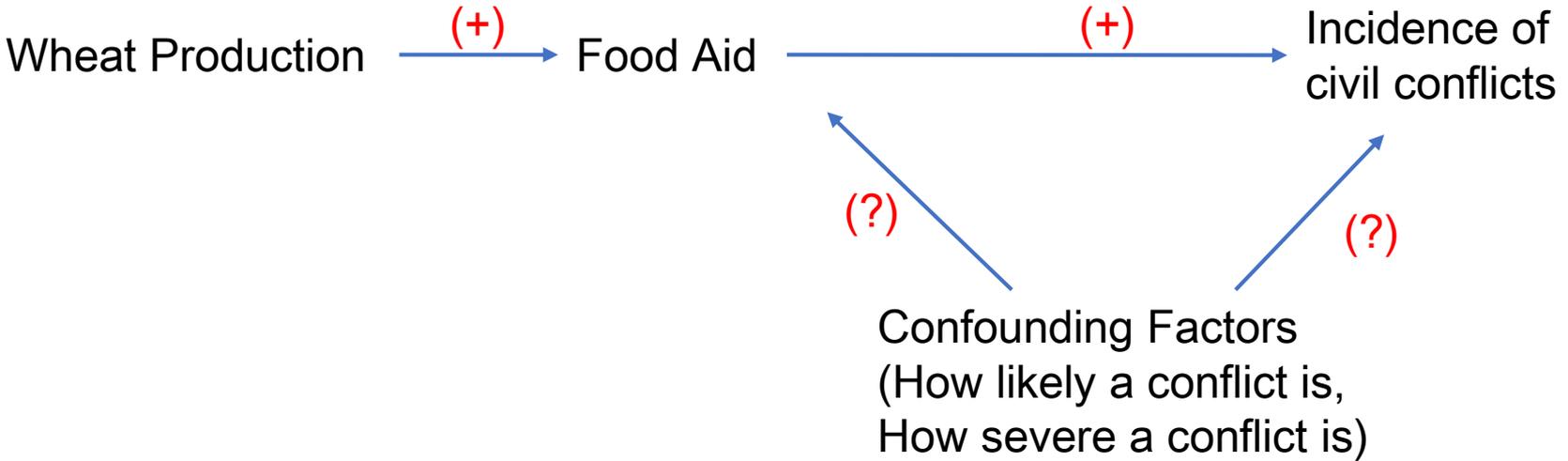
On other side, many people argue that foreign aid may do more harm than good

- Foreign aid may distort incentives or encourage corruption
- Foreign aid may not be cost effective

IV Approach to Foreign Aid

[Nunn and Qian \(2014\)](#) use US Wheat Production as IV for US Food Aid

- The U.S. contributes more in Foreign Food Aid when wheat harvests are strong. Using IV approach find evidence that Food Aid **increases** frequency and severity of civil conflicts.



Strong Wheat Harvest Followed By More Food Aid

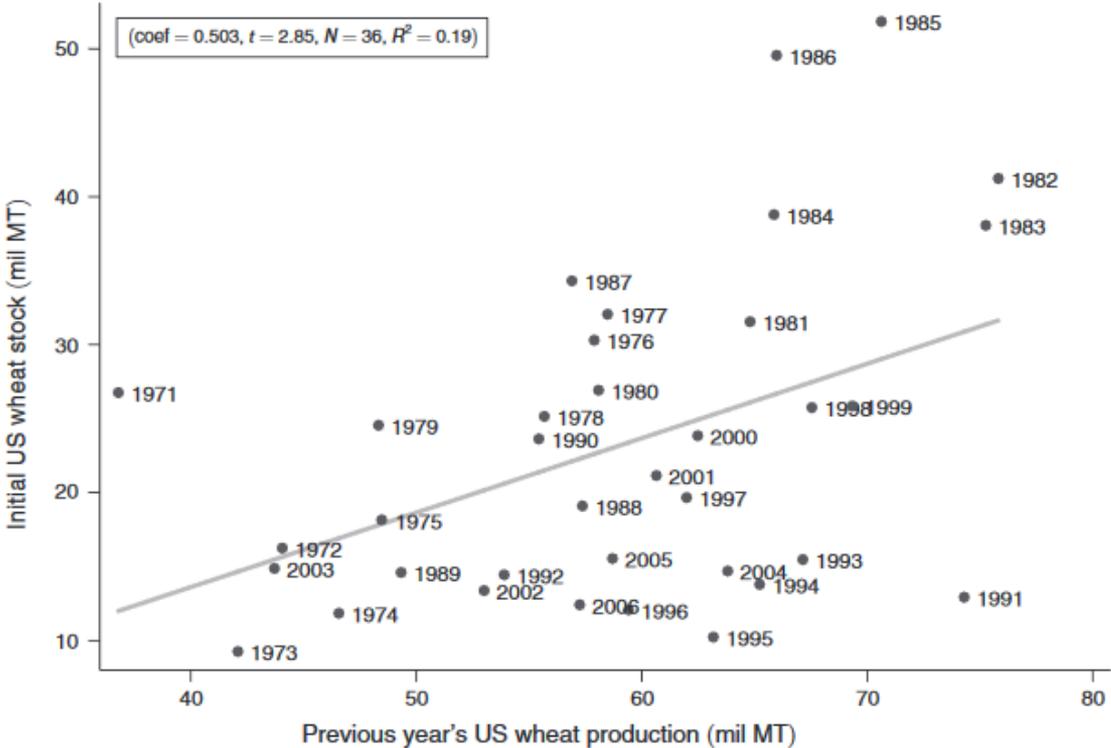


FIGURE 1. US WHEAT RESERVES AND LAGGED US WHEAT PRODUCTION

More Wheat Production Associated with More Civil Conflicts

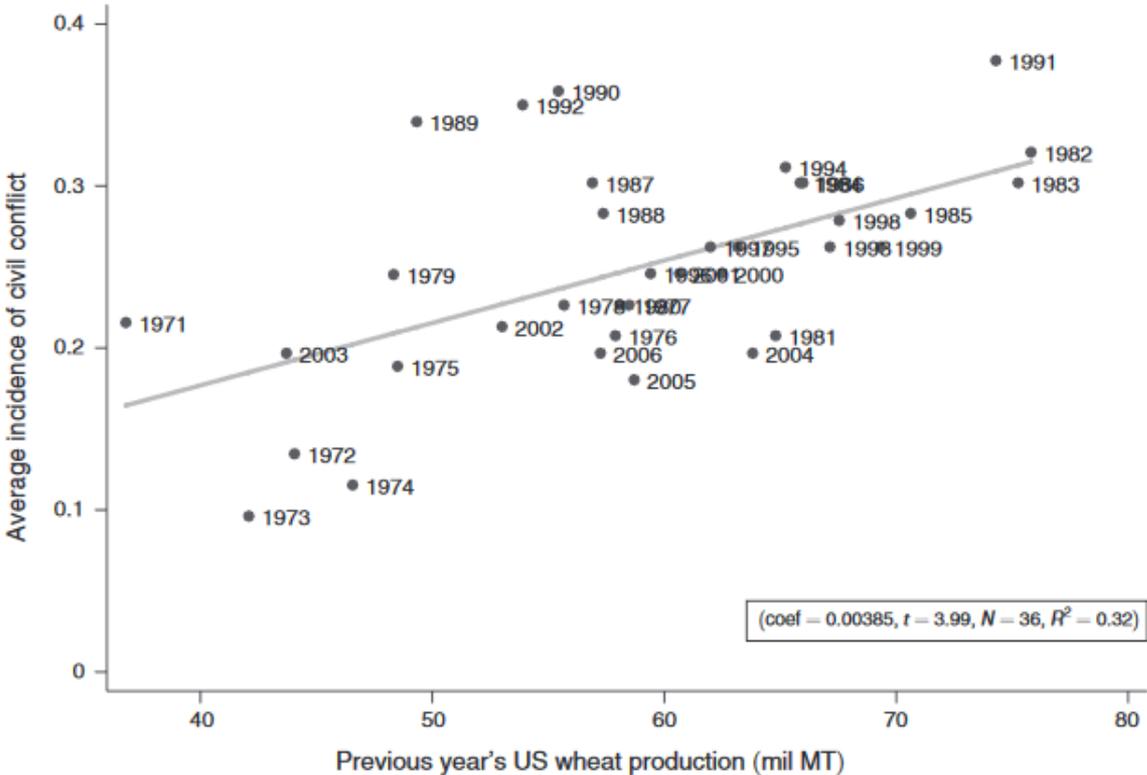


FIGURE 4. AVERAGE CIVIL CONFLICT INCIDENCE AND LAGGED US WHEAT PRODUCTION, REGULAR RECIPIENTS: $\bar{D}_{it} \geq 0.30$

Why Does Food Aid Cause Civil Conflicts?

Find U.S. food aid has a causal contribution in creating and prolonging civil conflicts

- Evidence that this is because food aid is stolen by armed groups
- This allows fighting to go on longer than it otherwise would

What the results tell us

- Important to carefully evaluate trade-offs of food aid policy
- Doesn't mean that food aid is bad or can't be done better (paper didn't study benefits)

What Makes Good Development Policy?

What do we need to keep in mind when designing development policy?

- Try to minimize obvious unintended consequences.
- Implementation is important. Design policy for the world we live in, not an ideal world.
- Learn from mistakes: We are improving, but still often wrong

Note: We often arrive at conclusions that may initially seem counter-intuitive

- Need to value results over appearances

General Principles for Development Policy

Very important to evaluate policies individually. That said, a few general principles

- Increase choices and opportunities available to people, rather than restrict them
- Address problems directly, not indirectly

Example of Ineffective Policy: Agricultural Policies in Developing Countries

- Give people land (often not suitable for farming), then heavily subsidize inputs

General Principles for Development Policy

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That said, a few general principles:

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Example: Agricultural Policies in Developing Countries

Strong evidence many agricultural policies are ineffective. Example:

- Give people land (often not suitable for farming)
- Heavily subsidize inputs and also place restrictions on output prices

Why does this policy exist?

- Food security is a huge problem. This allows people to grow own food
- Without subsidies and price controls, the farms would not be able to sustain themselves
- Credit limitations make it so people can't afford to buy inputs even if worth it

Example: Agricultural Policies in Developing Countries

Strong evidence many agricultural policies are ineffective. Example:

- Give people land (often not suitable for farming)
- Heavily subsidize inputs and also place restrictions on output prices

What are some problems?

- Traps people into being farmers. Offers them no choice (be a farmer or nothing).
- Encourages farms to be run inefficiently, which contributes to food instability
- Price controls lead to food scarcity and often higher prices

Example: Agricultural Policies in Developing Countries

How can the Policy be designed better? Depends what the source of problem is:

Poverty trap?

- Give people money and access to training. Allow them flexibility in opportunities.

Can't Afford Intermediate Inputs?

- If caused by credit limitations, extend credit to farmers
- Alternatively, just give farmers money. Allow them to decide what it's worth spending on.

Why Don't We Allow Flexibility in How Aid is Spent?

Common concern is that if you just give money to people, they may not spend it wisely

- Might encourage poor people to stop trying or become lazy if you give them income
- Might spend money on drugs, alcohol, or other undesirable activities
- Might be taken advantage of

However, recent studies refute that cash transfers are more prone to abuse

- Keep in mind, non-cash aid is often exchanged for cash at a discounted rate
- 80 Percent of people in one study were willing to sell food vouchers at 25-75% discount

What Happens When You Give the Poor Money

Recent studies examine what happens when you give money with few strings attached.

What they Spend the Money On

- Feeding their families, sending children to school, investing in businesses

What they Don't

- Drugs and alcohol. As an excuse to not work.

Much more work needs to be done. Giving money directly may not be a panacea.

- Evidence that it isn't less effective than other programs, but not clear it can end poverty.