

Moving Out of Aid Dependency



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Why Do Developing Countries Need External Aid?

- # Low domestic savings
- # Savings-Investment Gaps
- # Typically financing social sectors such as Poverty Reduction in the context of MDG's
- # Labour productivity, H/h incomes
- # Infrastructure Development – raising productivity and lowering cost of doing business.

Need External Aid to Trade themselves out of Poverty

- ✦ Through lower cost of doing business, increased factor productivity, LDC's products should become competitive in the international markets.

- ✦ Able to trade themselves out of poverty

But this should be supplemented by

- ✦ Most importantly Market Access-(Regional and International)

- ✦ Pursuance of prudent macroeconomic policies

Experience With Investment in Social Expenditure

- # Most of the external aid is in the form of Government budget support (BS)
- # Increased BS in the face of non-tradable supply bottlenecks could increase appreciation pressures if the net imports do not rise fast enough to offset the increase in domestic absorption.
- # Increasing prices of NT could be a symptom of absorption capacity issues (value for money), high income elasticity in the demand for NT that is not compensated for by an elastic price supply or demand.

Experience With Investment in Social Expenditure-cont

- ✦ Productivity gains from social expenditure take long to materialize
- ✦ In the meantime, the private sector is being crowded through the upward pressures on exchange and interest rates
- ✦ Some argue that the increased BS should be absorbed through the deterioration of the CAB meaning that developing countries should import more goods and services.
- ✦ Would depend on the type of imports-Machinery and equipment preferred to consumer goods.
- ✦ Unfortunately basis for expansion in government expenditure and CAB is on MDG related aspects.

Experience of countries that have graduated from aid

These countries have traded themselves out of poverty

Raised domestic savings to avoid reliance on foreign savings through

- Increasing incomes of the households through investments in infrastructure, improving technologies, marketing and processing
- Trade reforms such as lowering and unifying tariffs and dismantling of quotas and other non tariff barriers.
- Expanded markets: domestic, regional and international

Experience of countries that have graduated from aid

Macroeconomic reforms:

- # Pursued prudent fiscal and sound monetary policies.
- # Reforms in the financial sector- regulation and supervision, increased competition to spur better financial intermediation and reforms in the pension system.

Institutional reforms to ensure:

- # Effective and efficient property ownership (property rights) and contracts enforcements, honest and corrupt free public administration.

Experience of countries that have graduated from aid -Summary

- # Government expenditures specifically targeted at raising total factor productivity
- # Mobilizing domestic resources for development, specifically long term savings
- # Promoting international trade
- # Promoting the role of private sector through institutional development; simplifying business regulations, strengthening property rights, easing tax burdens, increased access to credit and reducing the cost of doing business

Enhancing aid effectiveness

- # Domestic will for reform.
- # Developing countries to design comprehensive development framework that raise economic growth and poverty reduction in a sustainable manner.
- # Reducing conditionality
- # Aid to finance human and physical Infrastructure: to ease infrastructure and other structural bottlenecks.
- # Aid should largely be given to countries pursuing good macro-economic policies
- # In other cases should take the form of TA, Relief and post conflict support.

Criteria for Allocating Aid to Enhance its effectiveness

- ✦ Predictability of aid flows over time
- ✦ Constraint allocation to absorption capacity of the recipient economy.
- ✦ Be allocated with a fundamental objective of increasing the recipient's productivity and reducing the costs of production through investment in human and physical infrastructure, and financial market deepening.
- ✦ Be allocated for supporting diversification of exports and reducing domestic supply side constraints, as well as the ability to comply with trade standards, raising productivity of the export sector itself and adopting the correct marketing strategies

In Conclusion

For Recipient Countries

- # Still need aid to trade themselves out of poverty including including regional approach; integration for trade and infrastructure development
- # However, simultaneous reforms needed to wean themselves out should be implemented e.g. promotion of trade, financial market development to mobilize savings, rationalization of government expenditures in favour of increasing productivity and lower costs of doing business
- # Institutional development to increase the absorption capacity via increased value for money.

In Conclusion

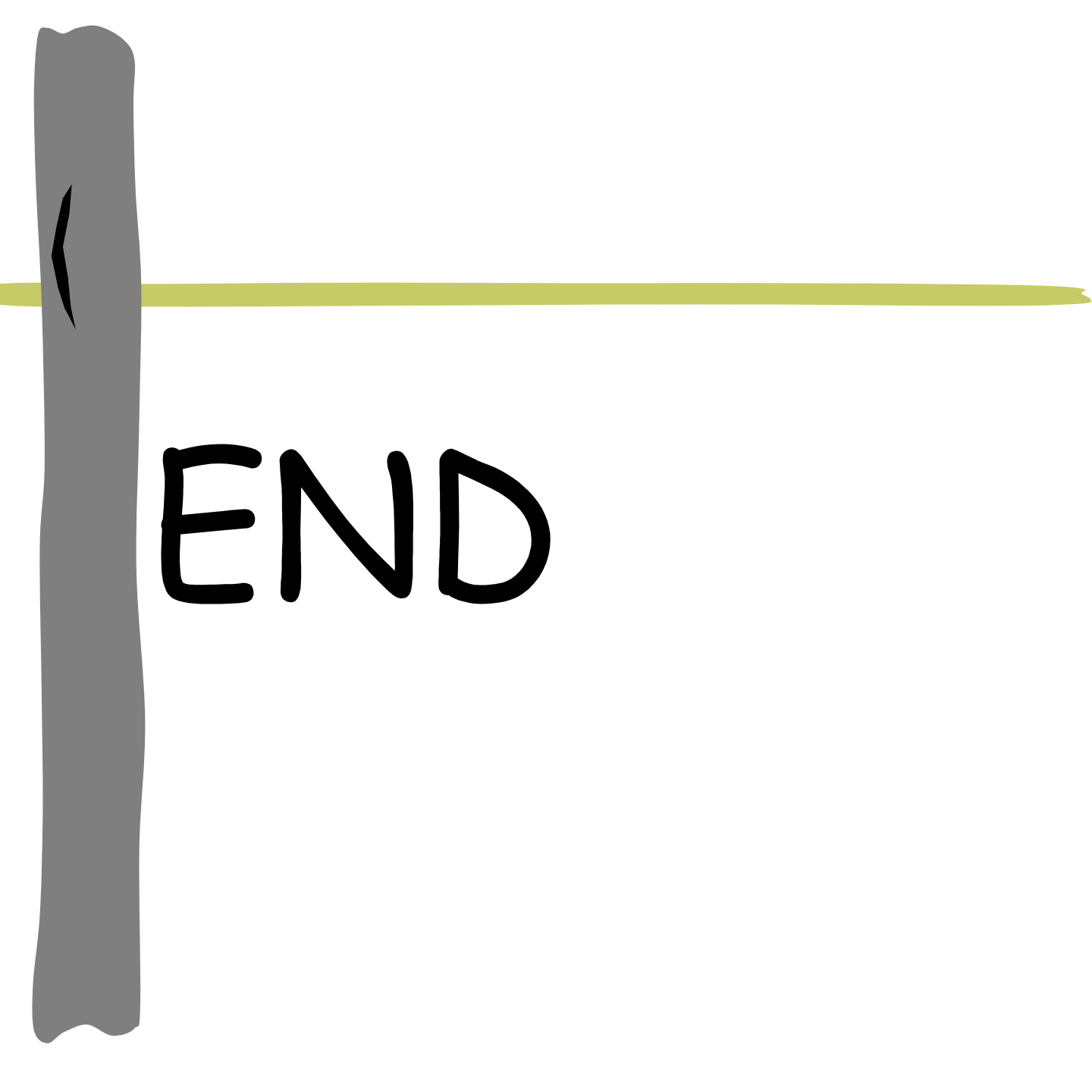
Donor Countries

- # Donor emphasis on MDGs without addressing physical infrastructure and other supply side constraints could leave developing countries aid dependant.
- # Donor aid could focus on the integration of developing countries in international trade. Consider financing sectors that reduce exports supply side constraints, as well as the ability to comply with trade standards, raising productivity of the export sector itself and adopting the correct marketing strategies

In Conclusion

Donor Countries

- # Increased access to international markets remains key.
- # Increase on predictability of aid flows over time
- # Less aid conditionality
- # Increased aid to countries pursuing good macroeconomic policies.



END