

Ties That Bind: The Impact of Tied Aid on Development

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Tied Aid

- Foreign aid is commonly characterized as money donors give to developing countries or NGOs in developing countries
- The characterization is only true of untied aid
- Tied aid is substantial
 - From US\$0.9 billion in 1973 to US\$11.6 billion in 2013
(excludes non-Western donors)
 - High of US\$263 per capita in Iraq in 2005
- ...but largely overlooked quantitatively (Knack and Smets 2013)

Research Question & Argument

How does tied aid affect development?

We argue tied aid should harm development because recipients lack incentive to comply with donors' development agenda

Method

Quantitative analysis of 3,159 country-years

152 developing countries (1973 – 2013)

Data from AidData on tied aid

&

The World Bank on compliance

Outline

- **Tied Aid: Mixed Motives**
- **Research Design**
- **Results**
- **Implications**

Mixed Motives: ODA and Export Subsidy

Companies – a “cartel of domestic interest groups over foreign aid”
get subsidies and lobby to maintain contracts



Andrew Natsios, USAID Administrator
(US State Department, 2005)



The New York Times, “U.S. Jobs Shape Condoms’ Role in Foreign Aid,” 29 Oct 2006



Mixed Motives: ODA and Export Subsidy

Recipients of US food aid contracts in 2010-11



The Guardian, "US Food Aid Programme Criticised as 'Corporate Welfare' for Grain Giants," 18 July 2012

Mixed Motives: ODA and Export Subsidy

**2013 Letter to U.S. Congress and White House from
the USA Rice Federation and the
American Maritime Congress**

“Growing, manufacturing, bagging, shipping and transportation of nutritious U.S. food creates jobs and economic activity here at home, provides support for our U.S. Merchant Marine ... and sustains a robust domestic constituency for these programs not easily replicated in foreign aid programs.”



Consequences for Development

- Leaders seek political survival (Buono de Mesquita et al. 2005)
- Implementing development agenda is costly and may not benefit political survival (Summers and Pritchett 1993; Buono de Mesquita and Smith 2010; Acemoglu and Robinson 2006)
- Tied aid is fungible (as is untied aid), allowing expenditures for patronage and security
- In contrast to untied aid, donor threat to withdraw tied aid is not credible

Ghana early 1990s

“One would think that holding one eighth of the annual import bill of a poor cash strapped economy would give enormous leverage to the World Bank and the donors to dictate terms to the Ghanaians. In fact, as the representative of the World Bank on the ground, I came under pressure from several sources ... to release the tranche ... There was a steady stream of private sector representatives ... arguing for release of the tranche ... because some of them had specific contracts with the government which were unlikely to be paid on time if the government did not in turn get the money from the World Bank and other donors ... The steady flow of aid is a source of income to many interest groups in the donor country. Their dominant concern is their income, not necessarily the wellbeing of the aid recipients. If conditionality is violated, the short term interest of these groups is for the aid to flow in any case (at least, that part of the aid which flows back to them).” – Kanbur (2006, 13)

Hypotheses

(1) Increases in tied aid should reduce per capita income

(2) Increases in tied aid should reduce per capita income when compliance with the donor development agenda is low

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Research Design

Dependent Variable : annual % change in per capita income (5-year ave after aid disbursement)

Sample: 3,159 country years (152 developing countries, 1973-2013)

Independent Variables: $\log(1+\text{tied aid})$ (lagged 5 year ave); compliance (average per country year) (Girod and Tobin 2016)

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“the extent to which the borrower complied with covenants and agreements. The following criteria are taken into account: government ownership and commitment to achieving objectives, adequacy of stakeholder involvement, timely resolution of implementation issues, adequacy of M&E arrangements and relationship with donors/partners” (Smets, Knack, and Molenaers 2012, 34).

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Controls: untied aid, GDP per cap, executive constraints, battle deaths, FDI per cap, infant mortality, resource rents per cap, country fixed effects

Model: OLS with standard errors clustered by country

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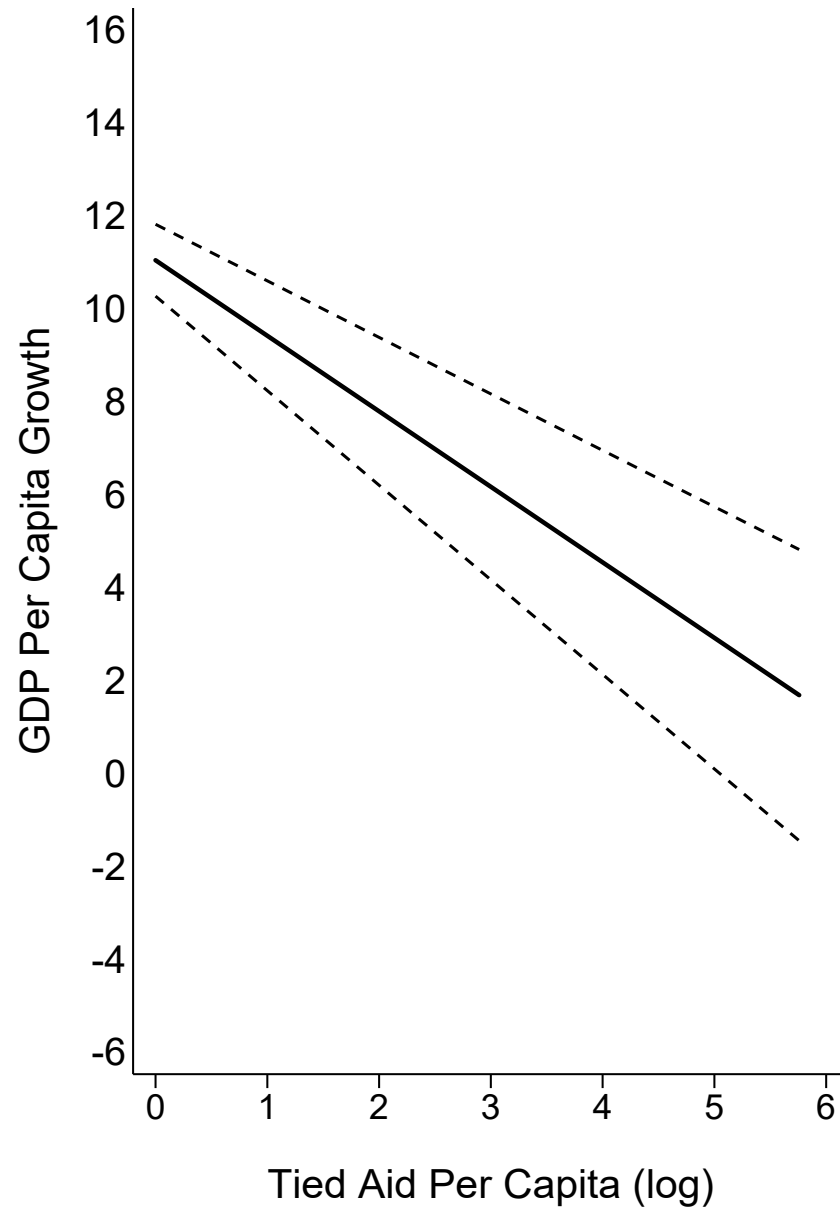
Key Results From Regression Analysis

(1)

Tied aid per capita	-1.753***
	(0.342)
Compliance	
Tied aid per capita X compliance	

Full results in paper

Marginal Effect of Tied Aid on Growth

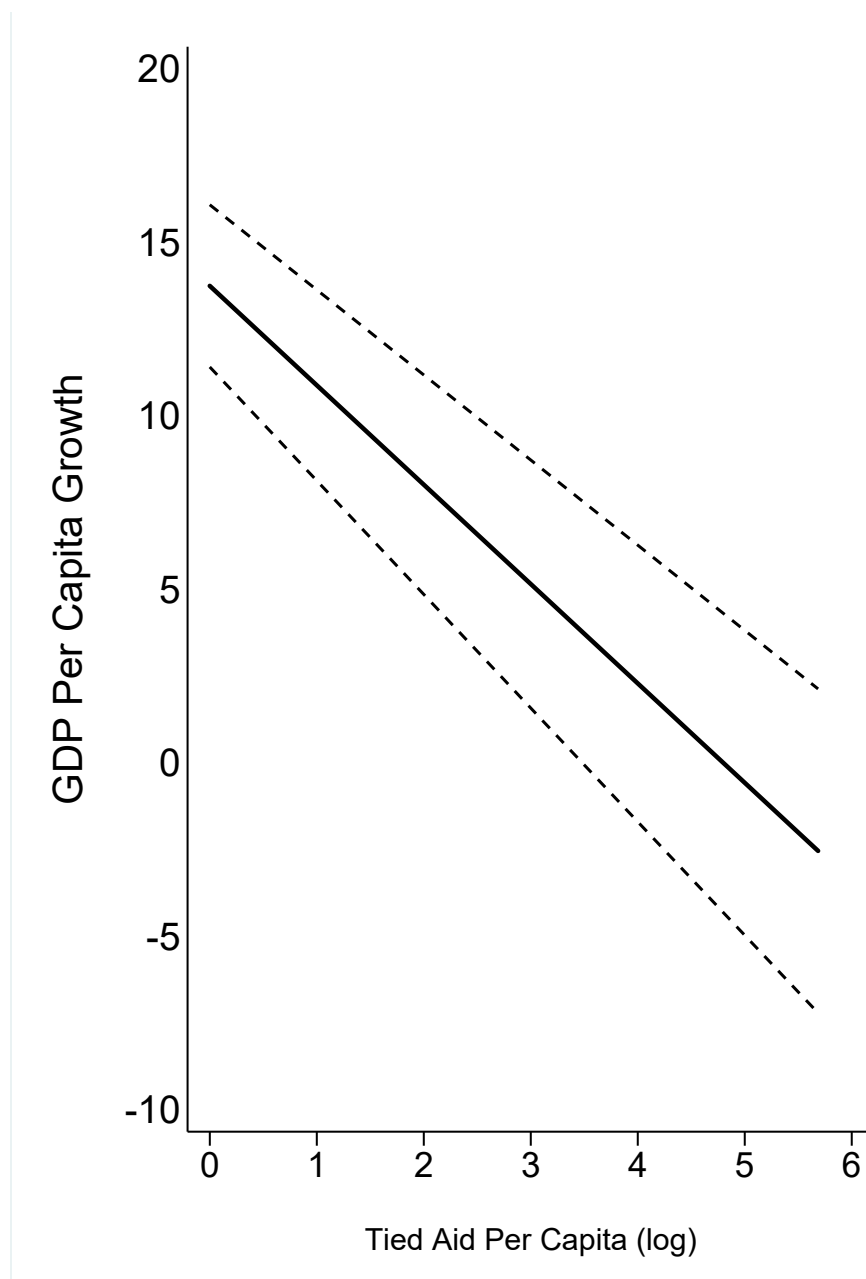


Key Results From Regression Analysis

	(1)	(2)
Tied aid per capita	-1.753***	-2.866***
	(0.342)	(0.601)
Compliance		3.318***
		(1.200)
Tied aid per capita X compliance		-1.393**
		(0.615)

Full results in paper

Marginal Effect of Tied Aid on Growth when Compliance is Low



To address potential endogeneity

1. Lag structure
2. System GMM
3. Instrumental variable: US wheat production (Nunn and Qian 2014)



Dejong, Peter in *The Guardian*, "US Food Aid Programme Criticised as 'Corporate Welfare' for Grain Giants," 18 July 2012

Additional Robustness Checks

1. Other controls
2. Changed DV to infant mortality
3. Changed IV to proportion tied aid
4. Included YFE, time trend
5. Changed lag structure
6. Excluded each donor
7. Excluded each recipient

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Implications

- Nascent literature on private sector and aid (Malik and Stone 2018; McLean 2017)
- Highlight that aid disbursement includes a controlling role for companies
- Tied aid may drive some of the negative effect of aggregate aid on development

Comments/Questions
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Figure 1: Marginal Effect of Tied and Untied Aid on GDP Per Capita Growth

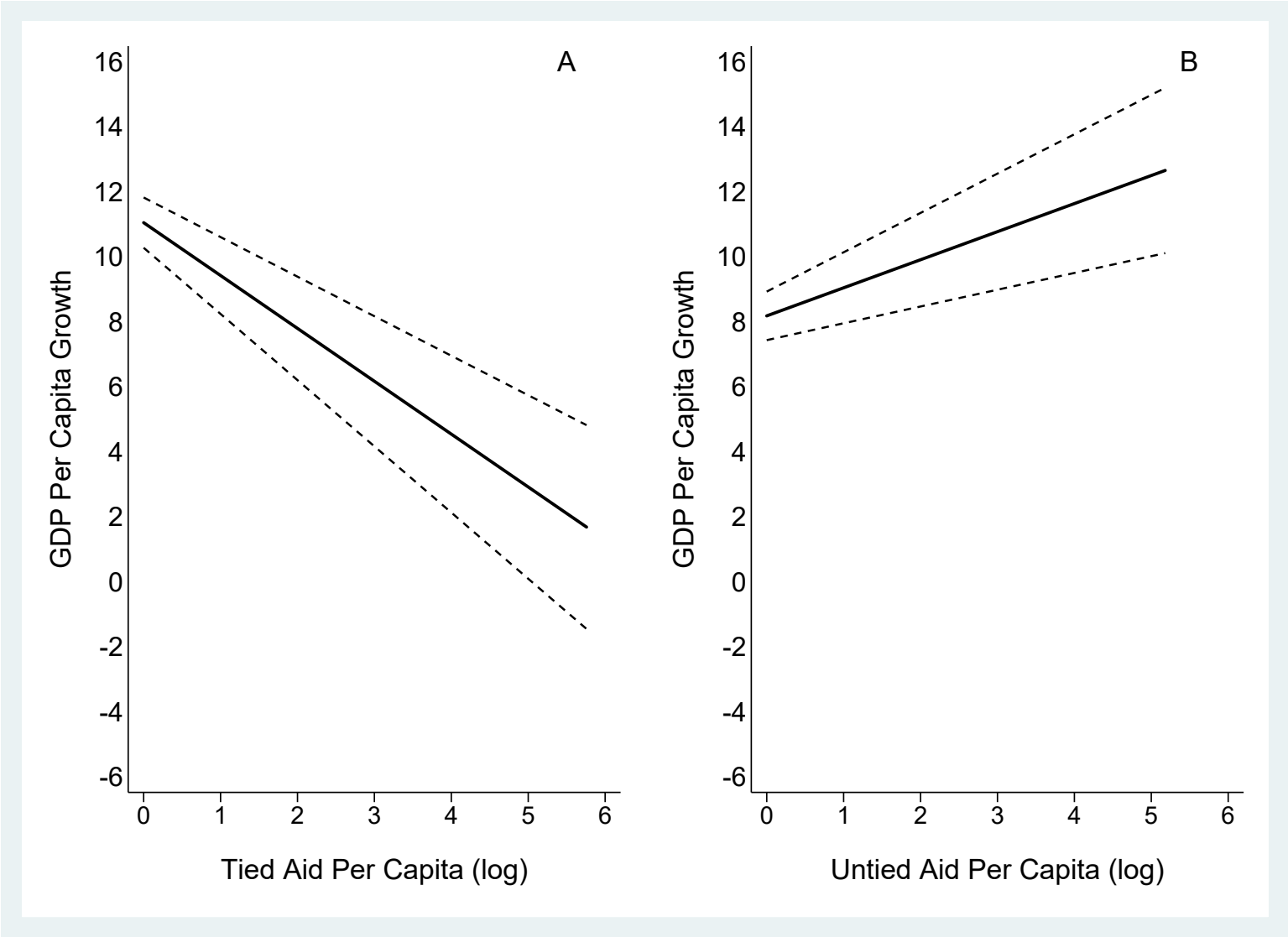


Figure 2: Marginal Effect of Low Levels of Compliance on GDP Per Capita Growth

