

What Is the Problem with Foreign Aid?

POSC 1020 – Introduction to International Relations

Steven V. Miller

Department of Political Science



Goal for Today

1. *Argue that an extreme form of terrorism (suicide terrorism) is rational/strategic.*
2. *Highlight how inferential fallacies and research design flaws can preclude a thorough understanding of the causes of suicide terrorism.*

The Problem of Foreign Aid

We'll be discussing **foreign aid**, defined as:

- The contribution of money, goods, or services to non-domestic actors for free or non-market prices.
- NGOs (e.g. Red Cross) can distribute foreign aid, but we'll focus on government-to-government foreign aid.

The Problem of Foreign Aid

Foreign aid (especially in the U.S.) has become a politically charged topic.

- It mostly fails to alleviate poverty, injustices, or inequalities.
- It routinely goes to the worst human rights abusers.
- It disincentivizes domestic development from the recipient.
- It's also subject to kleptocracy and misappropriation as well.

Why do we routinely observe the failure of what otherwise looks like “good” intentions?

The Exemplar of the Marshall Plan



What Can the Marshall Plan Tell Us?

The Marshall Plan remains the most ambitious (and essentially the first) U.S. aid plan and to much fanfare.

- We routinely connect U.S. aid to Europe's successful reconstruction.

Did the Marshall Plan actually *cause* Europe's recovery?

- The two clearly correlate (at least among those who did and did not receive aid).

However, the Marshall Plan may have worked because it was a *conditional* aid program.

- U.S. demanded important policy concessions (e.g. free markets, balanced budgets).

What Can the Marshall Plan Tell Us?

The success of the Marshall Plan may be limited to just Western Europe.

- WWII notwithstanding, Europe still had plenty of **human capital**.
- We've seen more failures than success stories for foreign aid in the developing world.

The Aid Debate

General agreement: foreign aid fails to meet its proposed goal for growth for the recipient.

- However, we disagree about the reasons why.

Jeffrey Sachs: rich countries don't give enough aid.

- e.g. the U.S. spends less than 1% of its budget on aid.
- However, this ignores that the amount of aid spent is an equilibrium strategy; the donors know they do not spend enough to reduce poverty.
- If aid has little impact on growth, then perhaps it is not intended to achieve growth.

The Aid Debate

William Easterley (other economists): recipient governments steal the money or use it ineffectively; aid should be given to local entrepreneurs.

- However, this does not consider the *political* consequences.
- Local entrepreneurs will be either co-opted or repressed by the government.

Perhaps we've been mistaken about aid's purpose.

- i.e. do donors and recipients ultimately care about poverty and injustice in the aid allocation process?

A Selectorate Theory Approach

A strategic approach could prove useful for understanding this problem.

- Foreign aid is given to buy policy concessions, not alleviate poverty.
- Aid programs *are* successful for this purpose *only*.
- Aid gives leaders the resources to solve societal problems, but incentives do to the opposite.

Selectorate Theory Approach and Aid's Key Questions

What does this mean for our key questions of foreign aid.

1. Who gives aid?
 - Wealthy countries with large W/S.
2. Who receives aid?
 - Poor countries with small W/S.
3. How much aid is given/acquired?
 - Wealthy countries spend the most, to a point.
 - Wealthier more democratic countries receive the most, to a point.
4. What are the internal economic consequences of aid?
 - Aid depresses economic and societal growth.
5. What are the political consequences of aid?
 - Aid depresses democratization efforts, despite proclamations to the contrary.

Aid and Democratization

Does aid increase democratization?

- Conventional wisdom: yes, indirectly. Aid promotes growth; growth promotes democracy.
- Selectorate answer: no. Aid inhibits democratization pushes.

Aid and Democratization

We know governments produce public goods, among them: **coordination goods**.

- The more coordination goods, the less likely citizens rebel.
- However, the more coordination goods, the *more* likely citizens would succeed in a rebellion.

Aid and Democratization

Let's offer a simple model of this scenario with these actors:

- L : incumbent head of state, who chooses to increase/decrease public goods.
- C : citizen, who chooses to revolt against or stay loyal to L .
- D : democratic revolutionary and challenger to L .
 - Note: in this model, D does not move.

Aid and Democratization

A few other key terms:

- g : public goods spent by L .
 - public goods have an implied unit price of p .
- z : private goods spent on W by L .
 - private goods have an implied unit price of W .
 - You should know what W is already.
- t, T : proposed taxation rate by L and D (respectively).
 - Note: $t > T$ (i.e. D is promising lower taxation rate than L).
- k : cost parameter for citizens associated with revolt.
- r : probability of successful revolt by citizens.

Aid and Democratization

Some more key terms:

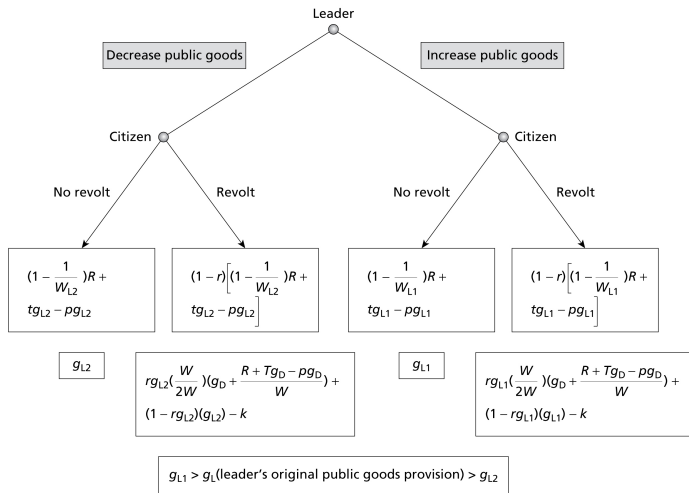
- R : (somewhat) labor-free sources of revenue (e.g. natural resources and foreign aid).
 - $R + tg_L$: total government revenue for incumbent L .

Also note: $R + tg_L \geq pg_L + Wz_L$

- i.e. total government revenue must be greater than or equal to the total cost of public and private goods.
- This is called a **budget constraint**. (i.e. we're ignoring deficit spending for simplicity)
- Likewise: $R + tg_D \geq pg_D + Wz_D$

A Simple Game

FIGURE 9.1 Incumbent Strategies to Avoid Rebellion



A Simple Game

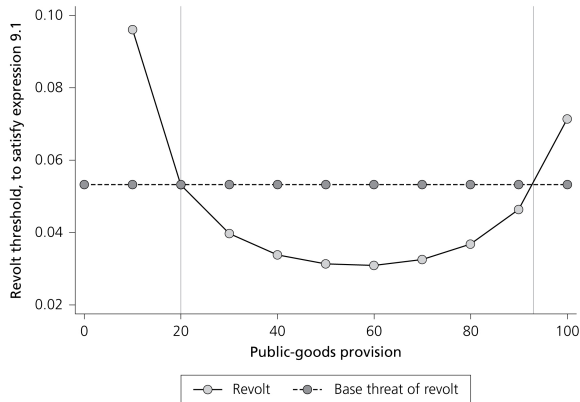
What's happening in this game?

- L faces a credible threat from D
- L chooses to placate (or disconcert) C with more or less public goods.
 - Recall our discussion of coordination goods.
- C chooses to revolt (or not) after L 's decision.

C revolts if its utility for doing so is greater than the public goods L offers it.

To Revolt or Not to Revolt?

FIGURE 9.2 To Revolt or Not to Revolt?

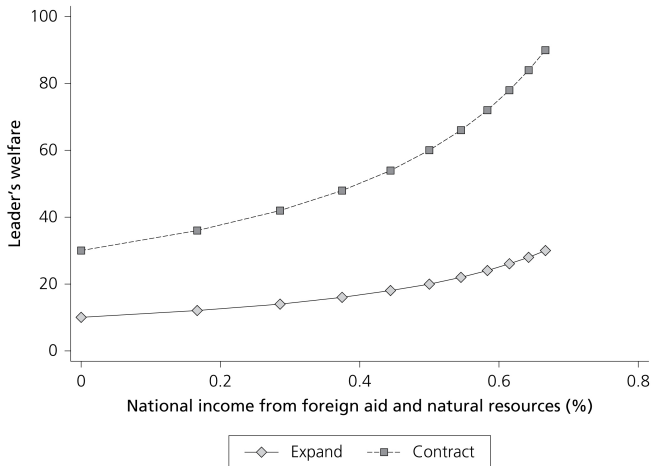


$W = 50$, $k = 100$, provision of public goods promised by revolutionary $D = 100$, and the base-line public goods under the existing regime = 20. The horizontal axis depicts the range of possible public-goods provision by the existing regime (0–100). Revenue from natural resources and foreign aid (R) is set at 400, the tax rate is at 70, and the unit price of a public good (p) is at 10.

The Resource Curse

FIGURE 9.3

Leader Incentives to Contract Public Goods and Increase Private-Goods Allocations as Labor-Free Sources of Revenue Increase



Conclusion

- Foreign aid provides the right amount of aid for enhancing leader survival.
- Foreign aid is intentionally given to leaders and governments that are corrupt.
- Foreign aid reduces economic growth and harms prospects for democratization.
- Survival-oriented democratic donors do what “We the People” want them to do, and it would be antidemocratic for them to do otherwise.
- If we REALLY want to alleviate poverty, we will put the really poor ahead of ourselves and then our leaders will increase aid and prevent its being stolen.

Conclusion (2)

There are multiple threats to leader survival.

- Free resources affect
- Resource curse

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