

# **FOREIGN AID AND ECONOMIC GROWTH IN PACIFIC ISLANDS**

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# SUMMARY

- **PACIFIC ISLAND COUNTRIES (PICS): AMONG THE WORLD'S TOP TEN RECIPIENTS OF OFFICIAL DEVELOPMENT ASSISTANCE (ODA) ON A PER CAPITA BASIS.**
- **UNTIL MID '90S, MOST OF ODA: FOR BUDGETARY SUPPORT.**
- **INTRODUCTION OF REFORMS IN ODA DELIVERY**
- **FOCUS ON PROGRAM-& PROJECT-TIED AID**
- **LATE 1990S: IMPROVING GOVERNANCE & GREATER DONOR COORDINATION**

# SUMMARY

- EXPECTATIONS THAT BETTER AID DELIVERY RESULTING IN GREATER EFFECTIVENESS DID NOT MATERIALISE
- CONTINUED STAGNATION IN SOME PICS AND DETERIORATION IN SOME OTHERS CAUSING CONCERNS
- SOME RESEARCH FINDINGS OF RELEVANCE

# DEFINITION OF AID

- PURE GRANTS
- CONCESSIONAL FLOWS FROM GOVTS & AGENCIES
- LOANS FROM MULTILATERALS
- LOW RATES OF INTEREST (1%: SERVICE CHARGE)
- LONG MATURITY PERIODS  
A GRANT ELEMENT OF AT LEAST 25%.

- IMF STUDY (2005) RANKED 10 TOP AID RECIPIENTS
- THREE OF THEM: FROM THE PACIFIC REGION
- CRITERIA: AID IN US\$ PER CAPITA (2000-2003 AVERAGE IN 2002 PRICES)
- FIRST AMONG THE TEN: TIMOR-LESTE (US\$ 260)
- KIRIBATI: RANKED THIRD (US\$180)
- VANUATU: RANKED FOURTH (US\$170)
- SOLOMON ISLANDS: RANKED SIXTH (US\$140).

# BENEFITS OF AID

- BUDGETARY SUPPORT: HIGH LEVEL OF PUBLIC EXPENDITURES
- SUPPLEMENTS DOMESTIC SAVINGS
- SUPPLEMENTS GOVT REVENUE
- ENABLES GOVTS: PRODUCTIVE INVESTMENTS
- IN FOREIGN EXCHANGE: ADDITION TO RESERVES
- CUSHION AGAINST PRESSURES ON EXCHANGE RATE
- EXCHANGE RATE STABILITY

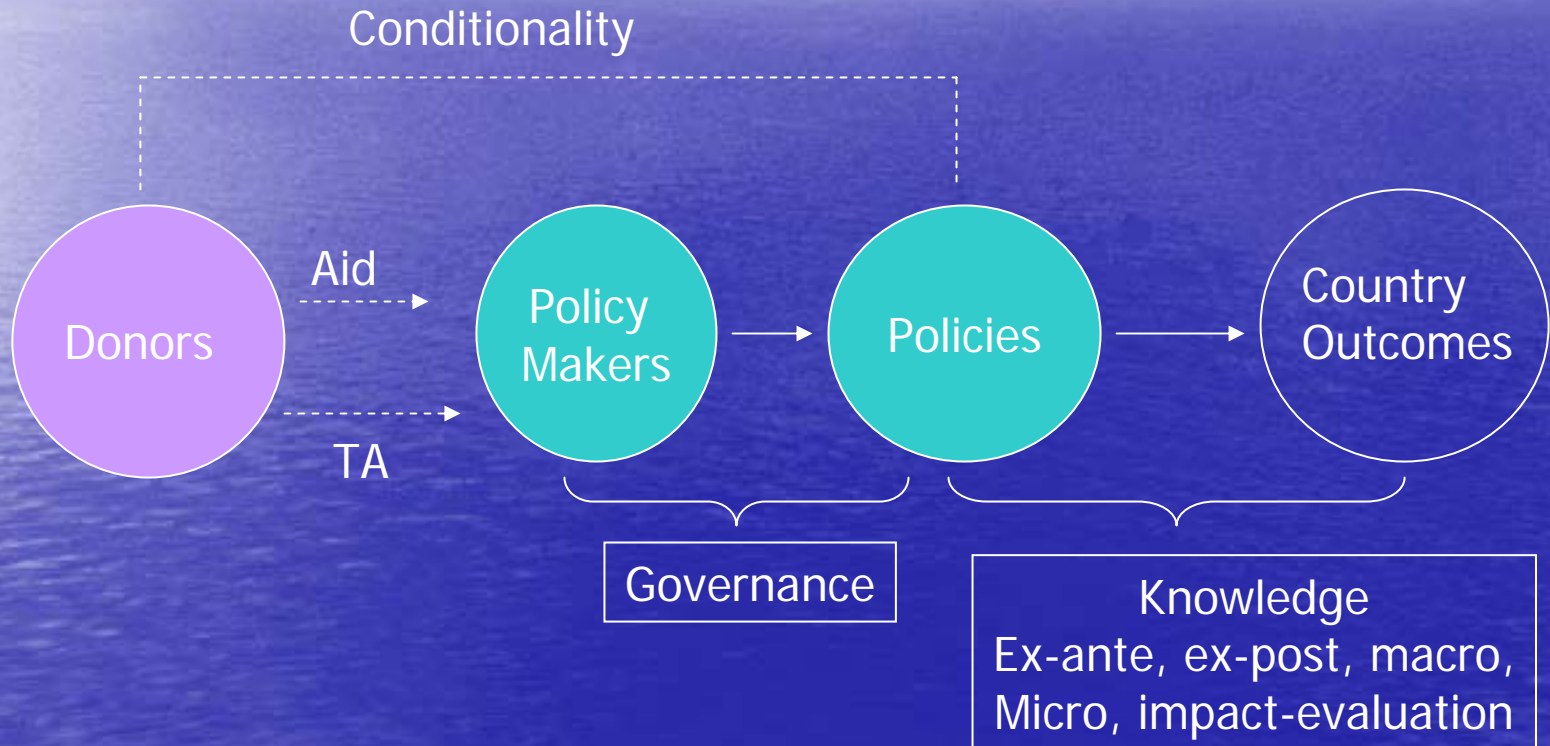
# QUESTIONS:

- DOES AID DISCOURAGE ADDITIONAL TAX EFFORT?
- DOES AID ENCOURAGE WEAK TAX MACHINERY?
- DOES AID LEAD TO HIGH RECURRENT EXPENDITURE?
- DOES FUNGIBLE AID (NOT TIED TO PROJECTS) LEAD TO GOVT CONSUMPTION?
- DOES AID LEAD TO EXCHANGE RATE APPRECIATION, DISCOURAGING EXPORTS?
- DOES AID LEAD TO DEPENDENCY SYNDROME?
- BOOMERANG EFFECTS OF AID: MORE BENEFITS TO AID GIVERS: CONSULTANTS & NO INCENTIVE TO CAPACITY BUILDING
- AID: "CAPTURE OF AID": CONSUMPTION BY ELITES & BUREAUCRACIES, DIVERTING FROM THE INTENDED PURPOSES (WINTERS 2005)
- AFRICAN CASE: "AID IS A TRANSFER OF WEALTH FROM THE POOR IN RICH COUNTRIES TO THE RICH IN POOR COUNTRIES" (ROBERT GUEST)

# HOW DOES AID WORK?

- UNCLEAR CAUSALITY CHAIN: LINKING AID TO GROWTH (IMF 2006: Macro Magmt.of Foreign Aid)
- MOST OF STUDIES DEAL WITH AGGREGATE AID DATA
- PROJECT AID IS MORE RELEVANT
- MOST OF PAST AID IS FOR NON DEV, MILITARY EXP, DISASTER RELIEF,
- WB STUDY (BOURGUIGNON AND SUNDBERG 2006): A BLACK BOX

# THE CASUALTY CHAIN – INSIDE THE BLACK BOX



# OPENING THE BLACKBOX (BOURGIGNON & SUNDBERG 2006)

- **POLICIES TO OUTCOMES: MACROECONOMIC STABILITY; TAX STRUCTURE; TRADE POLICIES LEADING TO INVESTMENT; PRODUCTION; GROWTH; POVERTY**
- **POLICY MAKERS TO POLICIES: PERSONS OF CAPABILITY; HONESTY; CHECKS AND BALANCES LEADING TO POLICIES**
- **DONORS TO POLICY MAKERS: AID AGENCIES (BILATERALS AND MULTILATERALS): INFLUENCING POLICY MAKERS THROUGH ADVICE; DEBATE; CONDITIONALITIES; TECHNICAL ASSISTANCE THROUGH CONSULTANTS.**
- **LIMITATIONS OF DONORS: POOR UNDERSTANDING; IMPERFECT KNOWLEDGE OF LOCAL ENVIRONMENT; IMPERFECT CONTROL OF IMPLEMENTATION OF POLICIES**
- **LINKS ALONG THE CHAIN: MEASURED AND MONITORED THROUGH EVALUATION: QUALITY & QUANTITY OF AID; QUALITY OF DONOR COORDINATION; GOVERNANCE CHARACTERISTICS; QUALITY OF DOMESTIC POLICIES; BENCHMARKING**

# TOWARDS NEW MODEL

- **CHANGES IN AID ARCHITECTURE: END OF COLD WAR 1990S; MILLENNIUM SUMMIT 2000; MONTERREY MEETING 2002**
- **TWO MAIN FEATURES: COUNTRY OWNERSHIP OF DEVELOPMENT STRATEGY & ALLOCATION OF AID ON PERFORMANCE**
- **NATIONAL POVERTY REDUCTION STRATEGY RATHER THAN BILATERALLY AGREED CONDITIONS; HARMONISATION OF PROCEDURES: MARCH 2006: PARIS DECLARATION ON AID EFFECTIVENESS SIGNED BY 100 COUNTRIES**
- **ALLOCATION OF AID ON BASIS OF PERFORMANCE MEASURED BY STRENGTH OF COUNTRY POLICIES AND MONITORABLE RESULTS (INTERMEDIATE INDICATORS; PERFORMANCE INDICATORS: VARIOUS ASPECTS OF POLICY ENVIRONMENT, INTERMEDIATE RESULTS AND FINAL OUTCOMES**
- **BOTH FEATURES POINT TO THE PRINCIPAL-AGENT MODEL AS A CONCEPTUAL FRAMEWORK**

# TOWARDS NEW MODEL

- **EXAMPLE: EMPLOYER (PRINCIPAL) HIRES A WORKER (AGENT): ASYMMETRIC INFORMATION**
- **EMPLOYER DOES NOT KNOW HOW MUCH WORK OUTPUT IS DUE TO WORK EFFORT AND HOW MUCH DUE TO GOOD OR BAD LUCK.**
- **THE SOLUTION IS TO ALLOW WORKERS TO CHOOSE THEIR WORK EFFORT LEVEL TO COMPENSATE THEM BASED ON RESULTS.**
- **DONOR CANNOT MONITOR AID RECIPIENT'S COMMITMENT TO REFORM NOR THE REAL IMPLEMENTATION OF REFORMS NEEDED TO ASSURE OUTCOMES**
- **AID PRACTICES IGNORE THIS FACT. RELY ON NON-ENFORCEABLE PRINCIPLE OF CONDITIONALITY.**

# EFFECTIVENESS OF AID

- **STUDIES: NO UNANIMITY ON NEXUS BETWEEN AID & GROWTH**
- **EARLIEST STUDY (1950): FRIEDMAN : CRITICAL OF LARGE BUREAUCRACIES ENJOYING ECONOMIC RENTS IN AID-RECIPIENT COUNTRIES.**
- **STUDIES USED AGGREGATED DATA: ABSENCE OF DETAILED DATA FOR PROJECTS, PROGRAMS AND TECHNICAL ASSISTANCE.**
- **ISLAM (1992) AND MBAKU (1993): STUDIES ON BANGLADESH AND CAMEROON: AID DID NOT CONTRIBUTE TO GROWTH.**
- **FINDINGS OF RECENT STUDIES: RANGE FROM NO LINK BETWEEN AID & GROWTH TO POSITIVE RELATIONSHIP FOR SOME COUNTRIES BUT WITH DIMINISHING RETURNS AS THE VOLUME OF AID RISES & PRESENCE OF A CONDITIONAL, POSITIVE RELATIONSHIP WITH GROWTH, UNDER CERTAIN CIRCUMSTANCES.**
- **CLEMENS, RADELET AND BHAVNANI (2004): EXISTENCE OF A POSITIVE RELATIONSHIP BETWEEN AID AND GROWTH**

- RAJAN AND SUBRAMANIAN OF IMF (2005): NO EVIDENCE OF AID HAVING EITHER A POSITIVE OR A NEGATIVE EFFECT ON GROWTH.
- RAGHURAM & SUBRAMANIAN OF IMF (2005): PRESENCE OF "DUTCH DISEASE EFFECT": APPRECIATION OF REAL EXCHANGE RATE
- DUTCH EFFECT: LARGER PART OF CONSUMPTION: NON-TRADABLES: RISE IN DOMESTIC PRICE LEVEL & REAL EXCHANGE RATE
- IMPACT: FALL IN COMPETITIVENESS OF LIMITED EXPORTS.
- WEAKENING ECONOMIC GROWTH.

- **WB STUDY ON PICS (1993): REVIEW OF TWO DECADES**
- **FAMOUS OBSERVATION: PACIFIC PARADOX**
- **POOR GROWTH IN PICS IN THE MIDST OF PLENTIFUL AID PER CAPITA**
- **ANNUAL GROWTH IN PER CAPITA GDP IN CARIBBEAN: 2.8%**
- **PICS: 1% GROWTH**
- **END OF COLD WAR PERIOD: CHANGE IN DONORS' PRIORITIES**
- **DONOR COORDINATION: INITIATION OF REFORMS**
- **WITH LOANS AND TECHNICAL ASSISTANCES FROM DONORS**
- **PROGRESS HAS BEEN SLOW AND UNCERTAIN**
- **SOME PICS IN THE LATE 1990S: ECONOMIC AND POLITICAL CRISES: TRACED TO POOR GOVERNANCE**

- CENTRE FOR INDEPENDENT STUDIES (CIS): *AID HAS FAILED IN THE PACIFIC* (HUGHES 2003).
- INEFFECTIVE USE OF AID DURING 30 YEARS : US\$ 50 BILLION
- FUNGIBLE AID: NOT USED FOR PURPOSES MEANT BUT WASTED
- IN SMALL PICS: ABUSE OF POWER BY SPECIAL INTERESTS:
- CIS 2004 REPORT: *THE PACIFIC IS VIABLE*
- STRESS ON AID DELIVERY
- AUSAID STUDY (2005): EXERCISES FOR A WHITE PAPER ON AID: PICS NOT ON TRACK TO MEET THE MDG
- FAILURE TO REGISTER ANNUAL PER CAPITA INCOME GROWTH AT 2% (1995-2004): THE REQUIRED RATE FOR REDUCING POVERTY (DOLLAR AND KRAAY 2001).
- LATEST STUDY BY AUS STRATEGIC POLICY INSTITUTE (2007): REDUCE GOVT TO GOVT AID: INVOLVEMENT OF PRIVATE SECTOR THROUGH TAX INCENTIVES: 150% TAX DEDUCTION (ROLAND RICH 2007)

# Selected Key Indicators

	Population ('000) 2002	Per Capita GDP (Current Prices) in US\$ 2002	Human Dev Index Ranking 2003	Aid per capita in US\$ 2002	Aid	
					% of GDP 1990	% of GDP 2002
<b>Caribbean Region</b>						
Antigua and Barbuda	76	10,449	60	192.1	1.2	1.9
Bahamas	314	15,797	50			
Barbados	270	9,423	30	12.8	0.2	0.1
Belize	256	3,382	91	88.6	7.6	2.6
Dominica	79	3,438	70	381.7	11.9	12.1
Dominican Republic	8745	2,514	95	18.2	1.4	0.7
Grenada	80	4,060	66	117.5	6.3	2.3
Guyana	765	937	107	84.9	42.6	9.0
Haiti	8132	415	153	8.9	5.9	4.5
Jamaica	2651	3,008	98	9.2	5.9	0.3
St.Kitts and Nevis	42	7,745	49	683.8	5.1	8.0
St.Lucia	1419	4,124	76	226.5	3.1	5.1
St.Vincent and the Grenadines	120	4,060	87	40.1	7.8	1.3
Suriname	436	2,199	86	26.9	15.5	1.2
Trinidad and Tobago	1303	7,384	57	5.6	0.4	0.1

# Selected Key Indicators

	Population ('000) 2002	Per Capita GDP (Current Prices) in US\$ 2002	Human Dev Index Ranking 2003	Aid per capita in US\$ 2002	Aid	
					% of GDP 1990	% of GDP 2002
<b>Indian Ocean</b>						
Maldives	280	2,182	96	88.9	9.8	4.4
Mauritius	1211	3,740	65	19.8	3.7	0.5
Seychelles	82	8,320	51	97.8	9.8	1.1
<b>The Pacific</b>						
Cook Islands	19	2,651	62	490.9	NA	28.0
Fiji	799	2,281	92	41.4	3.9	1.8
Fed States of Micronesia.	114	1,864	120	702.0	NA	37.4
Kiribati	85	530	129	203.3	22.5	18.6
Papua New Guinea	5,099	523	137	36.4	12.8	7.2
Republic of Marshall Islands.	51	2,008	121	823.3	NA	49.6
Samoa	175	1,484	74	214.2	42.6	14.5
Solomon Islands	418	541	128	56.8	21.7	11.0
Tonga	98	1,347	54	217.2	26.3	16.4
Tuvalu	11	345	118	260.0	47.2	45.0
Vanuatu	183	1,138	118	133.0	33.0	11.7

# Output Growth and Variability

	1990-2003 Average Growth Rate (%)	SD	1990-1997 Average Growth Rate (%)	SD	1998-2003 Average Growth Rate(%)	SD
<b>Caribbean Region</b>						
Antigua and Barbuda	3.2	3.0	3.0	3.6	3.3	0.8
Bahamas	0.4	3.8	0.9	3.5	2.2	1.4
Barbados	0.4	3.6	0.1	4.1	1.4	2.8
Belize	6.7	4.3	5.7	4.1	7.2	4.6
Dominica	1.4	2.3	2.7	1.4	0.5	3.1
Dominican Republic	4.7	4.0	3.9	4.6	5.0	2.2
Grenada	3.6	3.0	2.8	2.7	3.9	1.8
Guyana	3.3	5.2	5.9	4.1	0.5	3.2
Haiti	-0.4	5.4	-0.4	6.5	0.6	1.7
Jamaica	1.0	2.0	0.2	2.4	1.0	0.9
St.Kitts and Nevis	3.7	2.1	4.5	2.3	2.3	1.1
St.Lucia	1.7	3.2	2.7	2.4	0.8	4.8
St.Vincent and the Grenadines	3.2	2.5	3.3	3.0	2.7	1.7
Suriname	2.1	5.3	0.7	6.2	2.4	1.7
Trinidad and Tobago	2.9	2.6	2.0	2.3	4.2	1.6

# Output Growth and Variability

	1990-2003 Average Growth Rate (%)	SD	1990-1997 Average Growth Rate (%)	SD	1998-2003 Average Growth Rate(%)	SD
<b>Indian Ocean</b>						
Maldives	7.7	3.1	8.4	3.6	6.7	2.3
Mauritius	4.6	2.2	4.7	2.4	4.4	2.0
Seychelles	3.6	2.9	4.0	3.3	2.7	2.1
<b>The Pacific</b>						
Cook Islands	3.3	4.2	2.7	4.6	3.5	5.3
Fiji	1.6	3.7	2.6	2.4	2.7	4.2
Fed States of Micronesia.	1.8	4.0	2.3	5.1	0.2	4.6
Kiribati	2.9	5.8	3.0	2.8	5.0	4.5
Papua New Guinea	3.2	6.2	5.6	8.4	-0.2	3.9
Republic of Marshall Islands.	2.3	7.9	-0.9	7.7	0.3	4.6
Samoa	0.5	7.6	-8.1	11.2	3.9	2.1
Solomon Islands	0.1	5.6	2.9	3.8	-3.7	6.0
Tonga	2.5	2.8	3.3	3.5	2.3	2.1
Tuvalu	3.8	5.4	5.6	6.2	4.8	4.5
Vanuatu	2.1	3.7	4.4	4.0	0.8	3.4

# EMPIRICAL STUDY ON FIJI

- FIJI: LOWEST AID PER CAPITA & AID AS % OF GDP
- BILATERAL AID: 90% OF TOTAL AID: AUSTRALIA & JAPAN BEING THE MAJOR SOURCES OF ASSISTANCE.
- FIRST PIC: REFORMS IN 1988: DEREGULATING ECONOMY & DISMANTLING OF SUBSIDIES & RESTRICTIVE MEASURES.

# Net ODA: Geographical Distribution of Sources (US\$ Million Current Prices)

	1997	1998	1999	2000	2001	2002
Bilateral	39.1	35.8	38	28.7	24.0	31.3
Japan	16.9	19.2	20.9	15.1	12.7	18.7
Australia	13.9	11.2	11	10.7	8.5	8.6
Multilateral	4.4	0.6	-3.6	0.2	4.6	2.5
Total	44.5	36.8	34.9	29.1	28.6	33.8
Aid per capita (current prices)						
US\$	56.50	46.19	43.29	35.91	31.90	41.17
FJ\$	81.57	91.77	85.26	76.43	72.63	90.04

# FOR STUDY ON NEXUS BETWEEN AID & GROWTH IN FIJI

- ABSENCE OF DETAILED DATA ON AID BY CATEGORIES OF USE SUCH AS PHYSICAL AND SOCIAL INFRASTRUCTURAL PROJECTS
- TOTAL AID, CONVERTED INTO FIJI DOLLARS ADJUSTED FOR INFLATION AND THEN INCLUDE IN THE ANALYSIS AS THE REAL AID PER CAPITA (PCAID)
- NO CONSISTENT DATA ON QUALITY OF GOVERNANCE FOR 30 YEAR PERIOD
- AVAILABLE DATA ON RECURRENT EXPENDITURE
- REDUCTION IN RECURRING EXPENDITURE REFLECTS GOVT EFFICIENCY FOR REDIRECTING RESOURCES INTO PRODUCTIVE EXPENDITURES.

# FOR STUDY ON NEXUS BETWEEN AID & GROWTH IN FIJI

- ASSUMPTION: ALL NONCONSUMPTION EXPENDITURES ARE PRODUCTIVE INVESTMENTS.
- RETURNS FROM AID OVER TIME: SUBJECT TO DIMINISHING RETURNS: VARIABLE: REAL PER CAPITA AID SQUARED (PCAID<sup>2</sup>).
- VARIABLE: RATIO OF RECURRENT EXPENDITURES TO TOTAL EXPENDITURES (CETE): ALLOCATIONAL NATURE OF TOTAL BUDGET FUNDS INTO WAGES AND SALARIES AND OTHER HOUSEKEEPING EXPENDITURES.
- AN INTERACTION TERM BETWEEN REAL AID PER CAPITA AND THE RATIO OF RECURRENT EXPENDITURES TO TOTAL EXPENDITURE (PCAID\*CETE).
- REAL EXCHANGE RATE INDEX: OUTCOME OF PRUDENT FISCAL AND MONETARY POLICIES, AS THE COMPETITIVENESS OF EXPORTS IN AN OPEN ECONOMY IS CRITICAL FOR ECONOMIC GROWTH

# Fiji: Aid, Growth and Budget Details

Years	Real Per capita GDP F\$	Real Per Cap Aid F\$	Aid/GDP Ratio %	Budget Balance % of GDP	Ratio of Current Expenditures to Total Budget (%)	Ratio of Wages & Salaries to Total Budget (%)	Annual Inflation (%)	Annual per capita GDP Growth (%)
1970-79 (Ave)	1863.39	62.18	3.4	5.6	73.2	50.9	12.2	2.7
1980-84 (Ave)	2034.48	61.81	3.0	-11.3	77.7	58.3	8.9	-0.5
1985-89 (Ave)	1968.81	72.19	3.7	-6.4	85.1	52.2	6.0	1.0
1990-94 (Ave)	2234.28	79.53	3.6	-4.6	82.2	51.9	5.1	1.3
1995-99 (Ave)	3021.34	70.18	2.2	-4.7	76.2	50.5	3.3	1.3
2000	3220.07	57.96	1.8	-3.2	79.4	52.4	1.1	-3.3
2001	3288.23	51.30	1.6	-6.5	77.9	49.9	4.3	2.1
2002	3384.55	62.62	1.8	-5.6	75.3	49.3	0.8	2.9
2003	3461.64	NA	NA	-6.0	74.4	50.6	4.2	2.3
2004	3566.64	NA	NA	-3.2	77.4	50.7	4.1	3.0

# The Model

MODEL:

PCGDP = PER CAPITA GDP

PCAID= PER CAPITA AID

CETE= RATIO OF RECURRENT EXP TO TOTAL EXP

REER = REAL EXCHANGE RATE

$$\begin{aligned}LPCGDP = & 33.95 LPCAID^{***} - 3.94 LPCAID2^{**} - 1.25 LCETE^{***} \\ & (6.71) \quad (1.96) \quad (17.35) \\ & + 69.09 LPCAID * LCETE - 0.46 LREER^{***} \\ & (9.66) \quad (0.10)\end{aligned}$$

*\*\*\* indicates significance at 1 per cent level*

# RESULTS CONFIRM

- AID CONTRIBUTES POSITIVELY TO GROWTH
- AID IS SUBJECT TO DIMINISHING RETURNS
- HIGHER RATIO OF RECURRENT EXPENDITURE TO TOTAL EXPENDITURE HAS A NEGATIVE EFFECT ON GROWTH
- COMPETITIVE REAL EXCHANGE RATE POLICY PROMOTES GROWTH.

# **MORE ON DIMINISHING RETURNS OF AID TO GROWTH**

- **BENEFITS FROM AID INCREASE WITH INITIAL INFLOWS BUT AFTER ACHIEVING A CERTAIN LEVEL, THEY BEGIN TO DECLINE SO THAT THE COUNTRY WOULD ACTUALLY BE BETTER OFF WITH LESS AID**
- **POLICIES LESSENING AID ARE BENEFICIAL FOR GROWTH**
- **THEY RAISE THE EFFICIENCY OF AID (LENSINK AND WHITE 2000).**
- **PHENOMENON IS DEFINED AS THE AID LAFFER CURVE**
- **GRIFFIN (1970): POSSIBILITY OF A NEGATIVE EFFECT OF AID ON PRODUCTIVITY AND THEN ON GROWTH.**
- **AID WOULD REDUCE PRODUCTIVITY OF INVESTMENT**
- **IF THIS EFFECT WERE SUFFICIENTLY LARGE, AID WOULD REDUCE GROWTH.**
- **THIS CIRCUMSTANCE OCCURS BECAUSE GOOD POLICIES AND AID ARE "SUBSTITUTES" IN THIS CASE (BURNSIDE AND DOLLAR 2000).**

# WHAT IS THE BREAK-EVEN/TURNING POINT IN PER CAPITA AID ABOVE WHICH MORE AID HAS A NEGATIVE MARGINAL IMPACT ON GROWTH?

THE TURNING POINT OF PER CAPITA AID IS F\$74.17.

1. IF AID TO FIJI'S PER CAPITA REACHES F\$74.17, RATE OF ECONOMIC GROWTH WILL CRAWL TO ZERO
2. IF AID EXCEEDS THIS VALUE, THERE WOULD BE A NEGATIVE IMPACT OF AID ON ECONOMIC GROWTH, AS THE LAW OF DIMINISHING RETURNS WOULD OPERATE.
3. FIJI'S TURNING POINT (F\$74.17) IS MUCH HIGHER THAN AVERAGE PER CAPITA AID (F\$67.18) OVER THE PERIOD 1970-2002.

# INTERACTION TERM

- COEFFICIENT OF THE INTERACTION TERM BETWEEN PER CAPITA AID & RECURRENT EXPENDITURES TO TOTAL EXPENDITURE ( $PCAID * CETE$ ) IMPLIES THAT AID IS EFFECTIVE WHEN GOVERNMENT CONSUMPTION IS UNDER CONTROL.
- IF THE *CETE* IS MORE THAN 61.18 PER CENT, AID EFFECTIVENESS WOULD BE NEGATIVE.
- POLICY IMPLICATION: GOVT CUTS CONSUMPTION EXPENDITURE RATIO & RELEASE MORE FUNDS FOR DEVELOPMENT EXPENDITURE

# VANUATU CASE

- **TWO CIS STUDIES (2003 AND 2004): HIGHLY CRITICAL OF THE EFFECTIVENESS OF FOREIGN AID TO VANUATU.**
- **ANNOUNCEMENT IN MARCH 2006: US MILLENNIUM CHALLENGE CORPORATION APPROVED A FIVE-YEAR US \$65.69 MILLION COMPACT WITH VANUATU.**
- **THIS PROVOKED FURTHER CRITICISM FROM HUGHES AND SODHI (2006) THAT THE US GOVERNMENT DECISION WAS NOT JUSTIFIABLE IN THE LIGHT OF INEFFECTIVE USE OF AID IN VANUATU.**

- **ADB LOAN OF US \$20 MILLION FOR COMPREHENSIVE REFORMS PROGRAMME.**
- **FOR IMPROVING BUDGETARY PROCEDURES AND METHODS AND PREPARING MANUALS.**
- **ADB WAS JOINED BY AUSTRALIA: TECHNICAL ASSISTANCE IN TERMS OF EXPATRIATE SKILLS.**
- **GAY (2004): 42 INTERNATIONAL CONSULTANTS DESCENDED ON PORT VILA TO PREPARE MANUALS FOR VARIOUS MINISTRIES AND AGENCIES INCLUDING FINANCE AND PLANNING AND OTHERS. ONCE THEY LEFT, THERE WERE "FEW LASTING RESULTS" .**
- **GAY (2004): MAJOR PART OF ADB LOAN PROCEEDS: FOR PAYMENT OF EXPATRIATE SALARIES.**
- **ARTIFICIALLY GIVING THE ECONOMY A SHORT-TERM BOOST " (GAY 2004: 31).: "DUTCH DISEASE EFFECT"**

# EMPIRICAL STUDY ON VANUATU: FOR TESTING THE HYPOTHESES:

## PROCEDURES:

- **THREE-VARIATE MODEL: GDP, AID & EXPORTS**
- **TWO BI-VARIATE MODELS: AID & EXPORTS; EXPORTS AND GROWTH**
- **TRIVARIATE MODEL: TESTING THREE HYPOTHESES**
  1. AID ENHANCES PRODUCTIVE CAPACITIES
  2. HIGHER PRODUCTION & MOVEMENTS FROM HINTERLANDS IN RURAL COMMUNITIES AND REMOTE ISLANDS TO COMMERCIAL CENTRES AND PORTS WOULD LEAD TO RISE IN TRADITIONAL EXPORTS INCLUDING COPRA, BEEF AND FISH;
  3. RISE IN EXPORT WOULD RESULT IN GROWTH.
- **BIVARIATE MODELS: TESTING TWO HYPOTHESES**
  1. AID POSITIVELY INFLUENCES PRODUCTION OF EXPORTS
  2. EXPORTS POSITIVELY INFLUENCE GROWTH

# FINDINGS

- **MULTIVARIATE: ABSENCE OF LONG TERM RELATIONSHIP AMONGST THE THREE VARIABLES.**
- **TWO BIVARIATE MODELS:**
  1. AID DID NOT CONTRIBUTE POSITIVELY TO EXPORTS;
  2. EXPORTS POSITIVELY INFLUENCED GROWTH.

# RESULTS: NO SURPRISE

- BY ANALYZING THE DATA OF A MUCH SHORTER PERIOD AND WITHOUT EMPLOYING ANY SOPHISTICATED ANALYSIS, HUGHES AND SODHI (2006) CAME TO THE CONCLUSION THAT PAST AID DID NOT BENEFIT VANUATU.
- BY RESORTING TO A MORE DETAILED EMPIRICAL ANALYSIS OF DATA, WHICH ALSO COVERED A LONGER PERIOD, OUR STUDY CONFIRMED THE FINDING THAT AID DID NOT CONTRIBUTE TO GROWTH, BUT EXPORTS POSITIVELY INFLUENCED GROWTH.

# CONCLUSIONS

- VANUATU'S PROBLEMS ARE RELATED TO EXPORTS PRODUCTION & TRADE DEFICITS
- VANUATU'S PROBLEMS: MORE RELATED TO BALANCED REGIONAL DEVELOPMENT.
- AID SHOULD HAVE BEEN CONTINUED FOR GROWTH ENHANCING PROJECTS AND PROGRAMMES, INCLUDING OUTER ISLAND DEVELOPMENT

# CONCLUSIONS

- PROJECT AID WOULD HAVE RAISED RURAL INCOMES THROUGH AUGMENTING SUPPLY OF EXPORT-ORIENTED COMMODITIES THAT WOULD HAVE BENEFITED THE COUNTRY AS WELL.
- GAY (2004): VANUATU DID NOT HAVE PERSISTENT RISE IN DOMESTIC CREDIT
- VANUATU'S FISCAL & CURRENT ACCOUNT DEFICITS: SMALL AND SUSTAINABLE ACCOUNT DEFICITS
- NOT OF THE KIND FACED BY LATIN AMERICAN COUNTRIES.
- NO NEED FOR IMF- STYLE STRUCTURAL ADJUSTMENT LOANS.

# RECOMMENDATION

- **REDIRECTING AID TOWARDS PRODUCTION OF AGRICULTURAL EXPORTS ALL OF WHICH ARE GROWN BY RURAL COMMUNITIES.**
- **AID: FOR OUTER ISLAND DEVELOPMENT PROJECTS**
- **AID: FOR ROADS CONNECTING FARMS AS WELL AS HINTERLAND IN REMOTE, ISOLATED ISLANDS TO PORTS AND JETTIES FOR SPEEDY MOVEMENT OF EXPORTS SO THAT RURAL COMMUNITIES ARE BENEFITED THROUGH RISES IN THEIR INCOMES AS WELL.**

# RECOMMENDATION

- **DONOR AGENCIES SHOULD UNDERTAKE A FRESH EVALUATION OF THEIR PROGRAMMES.**
- **THEY SHOULD CAREFULLY REVIEW THEIR POLICIES: WHETHER THE EMPHASIS ON GOVERNANCE HAS BEEN OVERDONE.**
- **NEED FOR STRIKING AN APPROPRIATE BALANCE BETWEEN AID FOR IMPROVING GOVERNANCE & AID FOR INCOME GENERATING ACTIVITIES.**

The background of the slide is a deep blue color, representing a vast body of water. A bright sun is positioned on the left side, just above the horizon, creating a shimmering reflection on the water's surface. The sky above the horizon is a lighter shade of blue with wispy white clouds. The overall scene is serene and peaceful.

**Thank You**