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Articles

Aid Absorption and Spending in Africa: A Panel Cointegration Approach

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Abstract

This article focuses on the macroeconomic management of large inflows of foreign aid. It investigates the extent to which African countries have coordinated fiscal and macroeconomic responses to aid surges. In practice, we construct a panel dataset to assess the level of aid 'absorption' and 'spending'. This article departs from the recent empirical literature by utilising better measures for aid inflows and by employing cointegration analysis. The empirical short-run results indicate that, on average, Africa's l ... ts. This suggests ... been used to financ ... eserves, perh ... absorption increa ... resources have be ... nly weak evidence ... s suggest that the macroeconomic management of aid inflows in Africa has been significantly

better than often portrayed in comparable exercises. The implication is that African countries will be able to efficiently manage a gradual scaling up in aid resources.

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Notes

1 This approach may also have its limitations, as recipients may under-report the total amount of aid. Nonetheless, we still believe that this data is superior to the data reported by donors.

2 These were embedded in the 2002 Monterrey Consensus – an outcome of the United Nations International Conference on Financing for Development – and the 2005 Gleneagles G8 summit.

3 For a useful review of this literature see McGillivray and Morrissey (2001).

4 It is assumed that neither public spending is increased nor revenues lowered (through tax cuts), which means that aggregate demand remains unchanged. However, a 'balanced budget' approach (that is, a combination of higher/lower spending and taxes that leaves the non-aid fiscal deficit unchanged) is compatible with this result and can have a s

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6 McKin ue to a 'fear of in ntral bank.

7 In prac ssional loans.

8 Not surprisingly, the full sample shows lower absolute averages and higher standard deviations for the aid variables.

9 The robust versions of the Breitung and Hadri tests are implemented by the new STATA command ‘xtunitroot.’ See also Breitung (2000) and Hadri (2000).

10 The LLC and IPS tests require N to be relatively smaller than T, which is not the case here.

11 For each time period, the mean of the series (across panels) is calculated and then subtracted from the observations.

12 The PMG methodology, for example, requires that foreign aid is exogenous. This may not constitute a major concern since our aid variable only includes aid grants. Aid loans (such as IMF lending) tend to be more responsive to domestic conditions (for example, balance of payments crisis and fiscal imbalances).

13 There might be concerns of reverse causality (for example, higher fiscal deficits causing higher inflation), since only the first two methodologies provide corrections for endogeneity. However, an increase in the non-aid fiscal deficit does not necessarily translate into an increase in money supply. It can be covered by the additional aid inflow, which appears to be the case. Moreover, the coefficients are almost identical to those from SYS-GMM.

14 The two long-run coefficients of the explanatory variables are now allowed to vary, that is, (25–1)*2 = 48.

15 Note that an increase in DRY means a fall in international reserves.

16 We have also estimated OLS-FE and DIF-GMM for the lagged dependent variable model, and the results indicate that these estimators tend to underestimate both short- and long

17 Buffie ... approach to mana ... have been corre

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