Oxford Development Studies ›

Volume 40, 2012 - Issue 2

Articles

Foreign Aid: Good for Investment, Bad for Productivity

Eskander Alvi & Aberra Senbeta

Pages 139-161 | Published online: 03 Apr 2012

Cite this article https://doi.org/10.1080/13600818.2012.675053

Abstract

This paper examines the effects of aid on sources of growth: capital accumulation and total factor productivity (TFP) growth; the latter captures the effect on growth after removing the contribution of factor accumulation. Given the role of TFP in explaining cross-country differences in income levels and growth rates, the productivity effect can play a significant role in explaining the impact of aid on growth. Contradictory effects of aid were found: aid boosts investment but adversely affects TFP, suggesting that efficiency losses may undermine the overall effects of aid on growth. It was also found that aid reduces the efficacy of financial institutions in supporting productivity growth, a surprising result that possibly illuminates the nature of aid distribution in receiving countries.

Notes

1. The significance of TFP growth in explaining cross-country variations in the level and growth of income has been questioned by some studies, which found no significant role for TFP growth. For instance, Young (1995) shows that factor accumulation was key to the growth miracle of some East Asian countries. Abu-Qarn & Abu-Bader (2007) also examined the sources of growth in 10 Middle East and North African countries and found that the explanatory power of variation in TFP growth is negligible.

2. Average annual growth rate of TFP is computed as $TFPgrowth = [\ln A_t - \ln A_{t-1}] * 100/5$.

3. Ø(s) is a piecewise linear function with different slopes. For instance, the return to education for ≤ 4 years of education is assumed to be 13%.

4. Hausman test for random-effects versus fixed-effects model (with null hypothesis of random-effects model); we reject the null with $\chi_{(11)}^2 = 44.42\ (0.0000)$.

5. In all cases, we do not reject the null that the instruments are valid and there is no second-order autocorrelation.

6. The results are available on request.

7. The excluded countries are China, Democratic Republic of Congo, Iraq, Malawi, Mozambique and Papua New Guinea.

The effects of openness, trade orientation, and human capital on total factor productivity

Source: Journal of Development Economics

Can the World Cut Poverty in Half? How Policy Reform and Effective Aid Can Meet International Development Goals

Related research