

Do Pacific Countries Receive Too Much Foreign Aid?

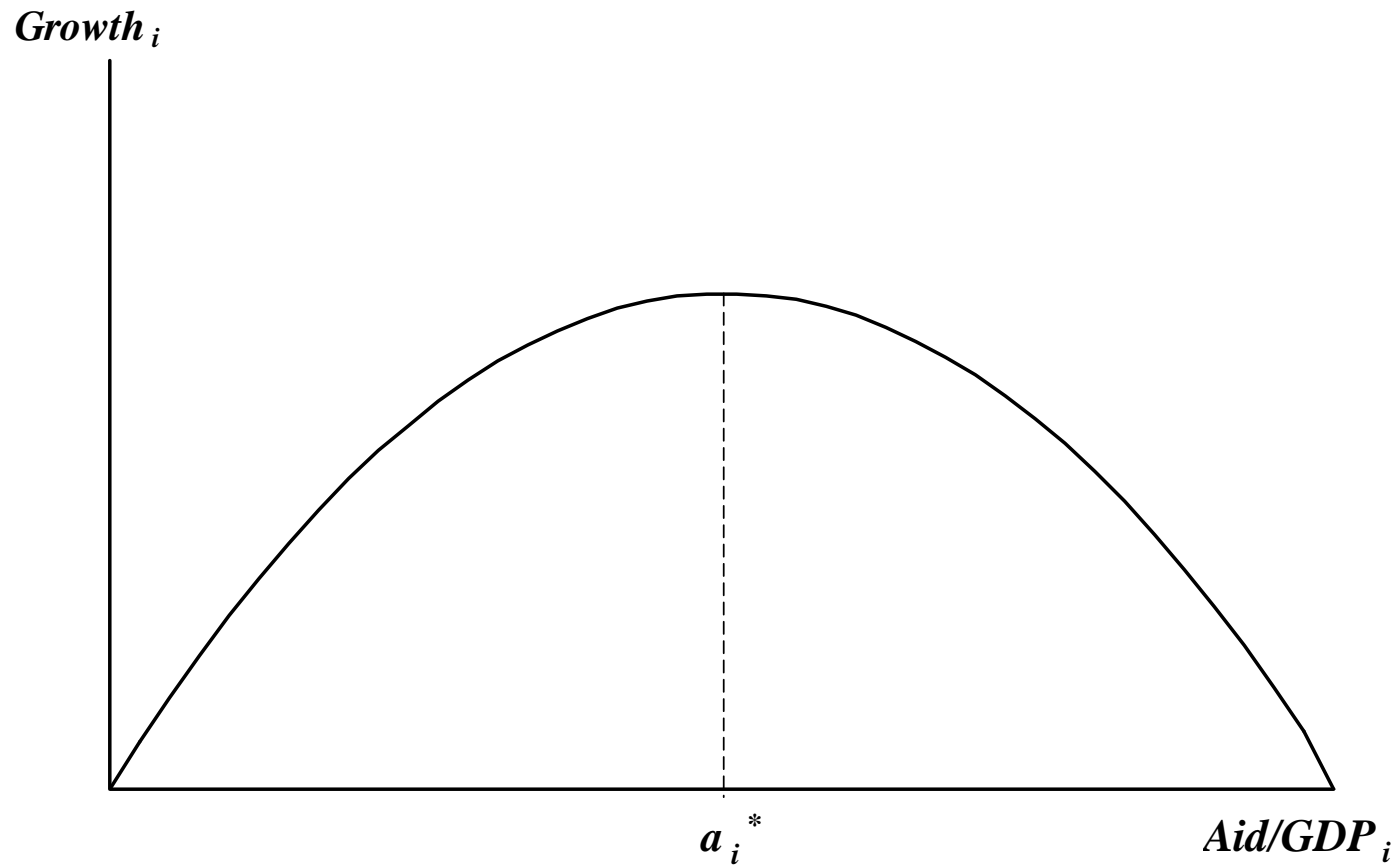
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The Aid Effectiveness Literature

- Focused on evaluating the impact of aid on growth
- The impact of aid varies but - on average – it spurs economic growth in recipient countries
- However, the impact of aid on growth is subject to diminishing returns
- Implication is that there are limits to the amounts of aid that recipient countries can absorb effectively

The Contribution of Aid to Growth



What Causes Diminishing Returns to Foreign Aid?

- Human capital constraints
- Policy/institutional constraints
- Macroeconomic
 - Real exchange rate appreciation / export competitiveness
- Infrastructure
- Poor donor practices

When Do Diminishing Returns to Aid Occur?

Studies indicate that diminishing returns sets in when aid accounts for approximately 20 per cent of a recipient's GDP

Important Message.....

- Absorptive capacity constraints do NOT imply that donors should stop scaling up their aid programs
- The global aid budget would need to increase to US\$1,466 billion to account for 20 per cent of GDP in all developing countries
- But – it's important to get the allocation of aid across countries right

How Much Aid do Pacific Countries Receive?

	Ratio of ODA to GDP (%) 2005-08
Fiji	1.7
Kiribati	22.9
Marshall Islands	37.1
Micronesia, Fed. Sts.	42.4
Palau	19.9
Papua New Guinea	4.8
Samoa	8.9
Solomon Islands	42.4
Tonga	9.3
Tuvalu	51.2
Vanuatu	11.5

Conclusion/Policy Responses

- Donors must examine closely the levels/impacts of their aid to seemingly 'over-aided' countries

Options (other than reducing aid) include:

- (i) Relieve absorptive capacity constraints
 - (ii) Work around existing constraints
- Donors should be cautious not to 'over-aid' some Pacific countries when scaling-up