

On the Cyclical and Stabilizing Profiles of Aid Flows in LICs

Evidences from Case Studies

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Aim of this project

1. Gain a better understanding of the stylized facts associated with the different cyclical and stabilizing profiles of aid flows:

Case 1: Pro-cyclical + Stabilizing

Case 3: Contra-cyclical + Destabilizing

Case 2: Contra-cyclical + Stabilizing

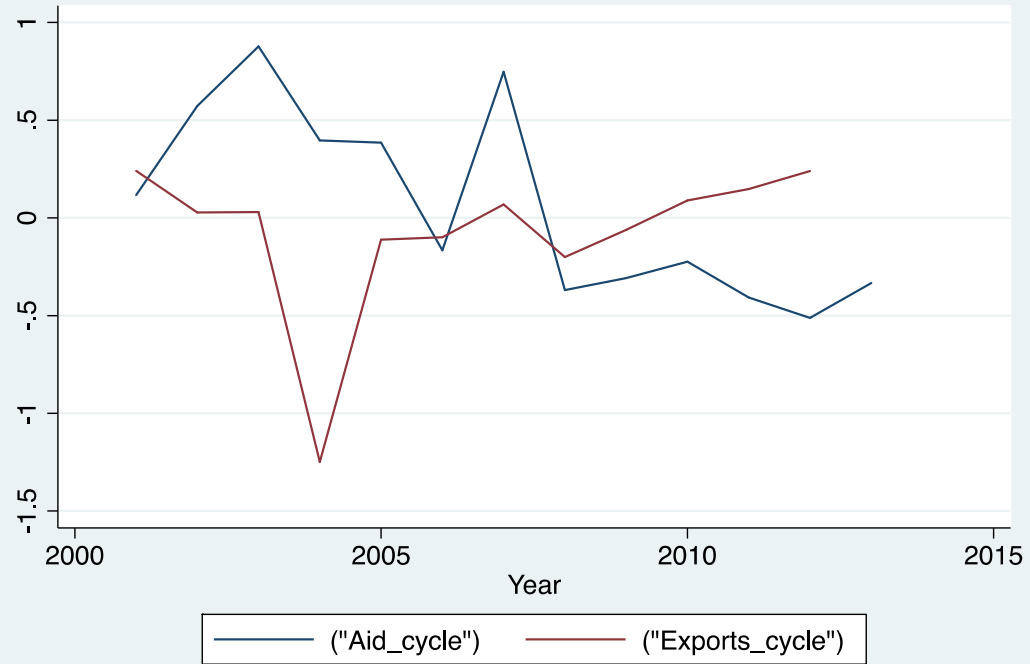
Case 4: Pro-cyclical + Destabilizing

2. Explain the macroeconomic implications associated to those profiles

Case studies selection

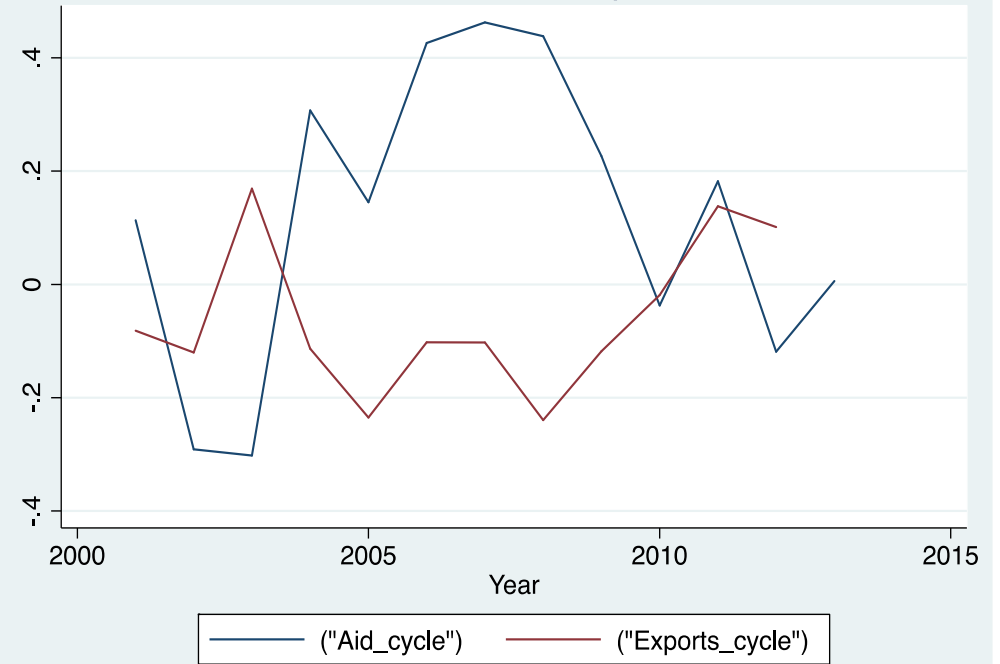
Cas 1

Liberia

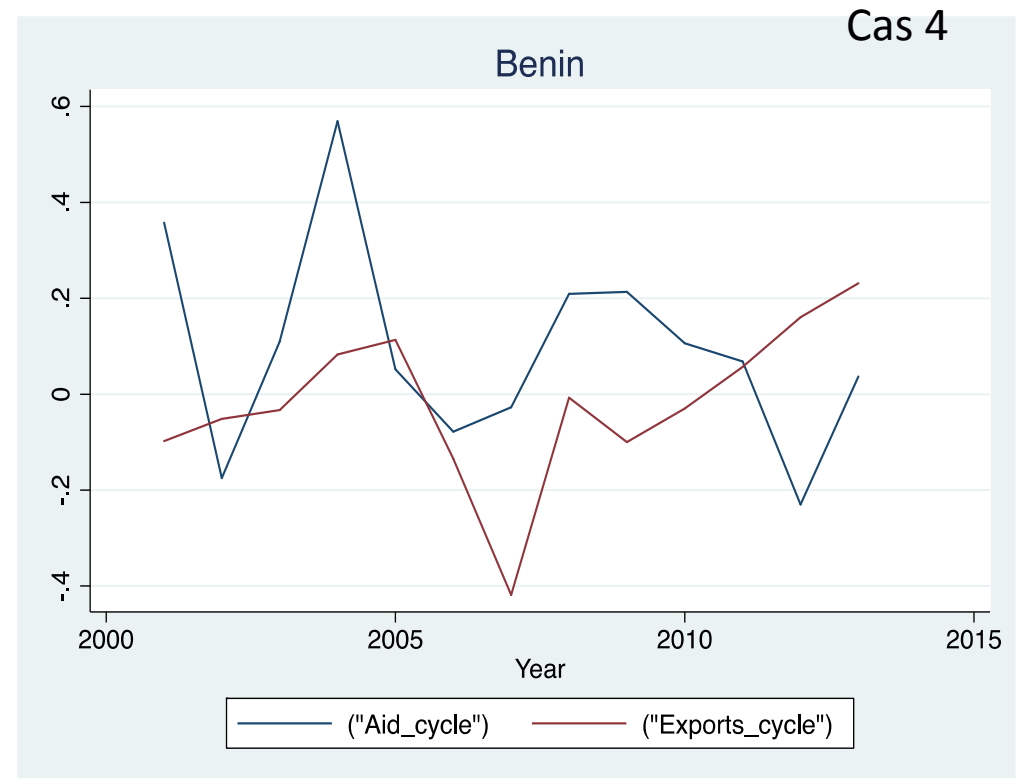
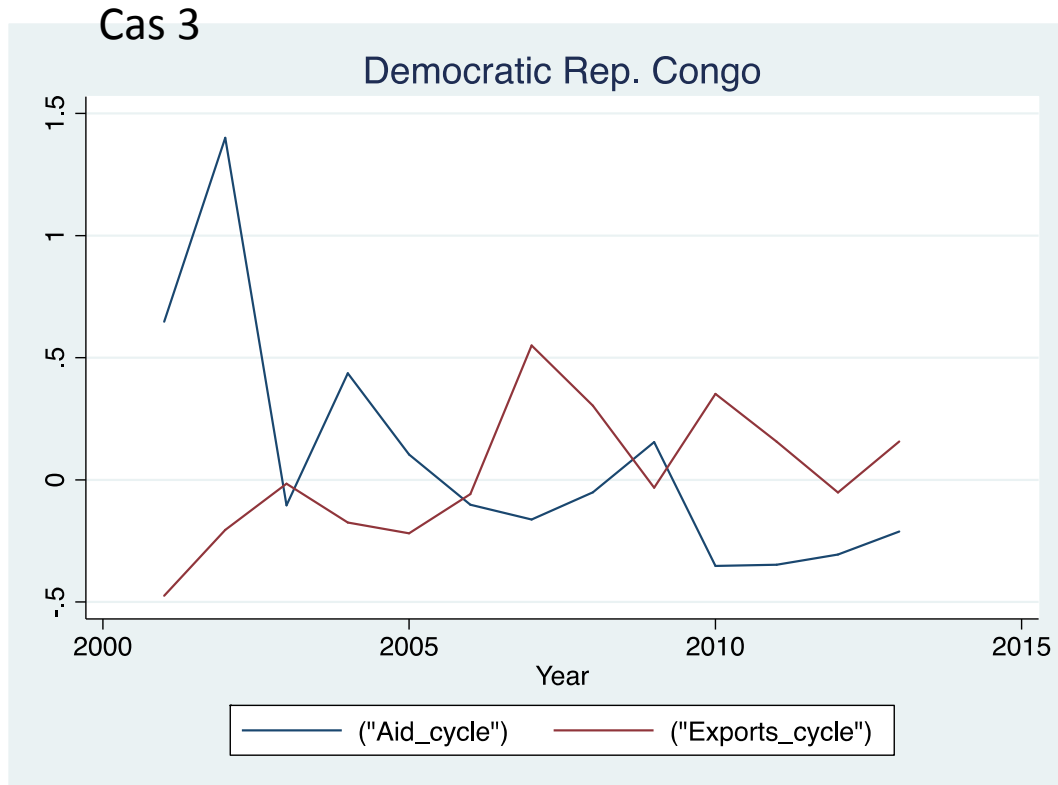


Cas 2

Central African Republic



Case studies selection



Methodology and Empirical strategy

First, we develop a framework to examine the relevance of Foreign Aid and other ECF (Remittances and FDI) for macroeconomic volatility in LICs.

The framework includes:

➤ A variance decomposition analysis:

To Quantify the contributions of each flow to Output volatility

➤ A Business Cycle model :

To evaluate the stabilizing property of foreign aid flows and the determinants/channels explaining the stabilizing property of aid flows

$$\sigma_{i,t} = \alpha_1 A_{i,t} + \alpha_2 R_{i,t} + \alpha_3 F_{i,t} + X'_{i,t} \beta + u_i + f_t + \varepsilon_{i,t} \quad \text{2SLS}$$

$$\Delta y_{it} = \phi_i (y_{it} - \theta' X_{it}) + \sum_{j=1}^{p-1} \beta'_{ij} \Delta y_{i,t-j} + \sum_{j=1}^{p-1} \delta'_{ij} \Delta X_{i,t-j} + \sum_{j=1}^{p-1} \gamma'_{ij} Z_{i,t-j} + \mu_i + \varepsilon_{it} \quad \text{PMG}$$

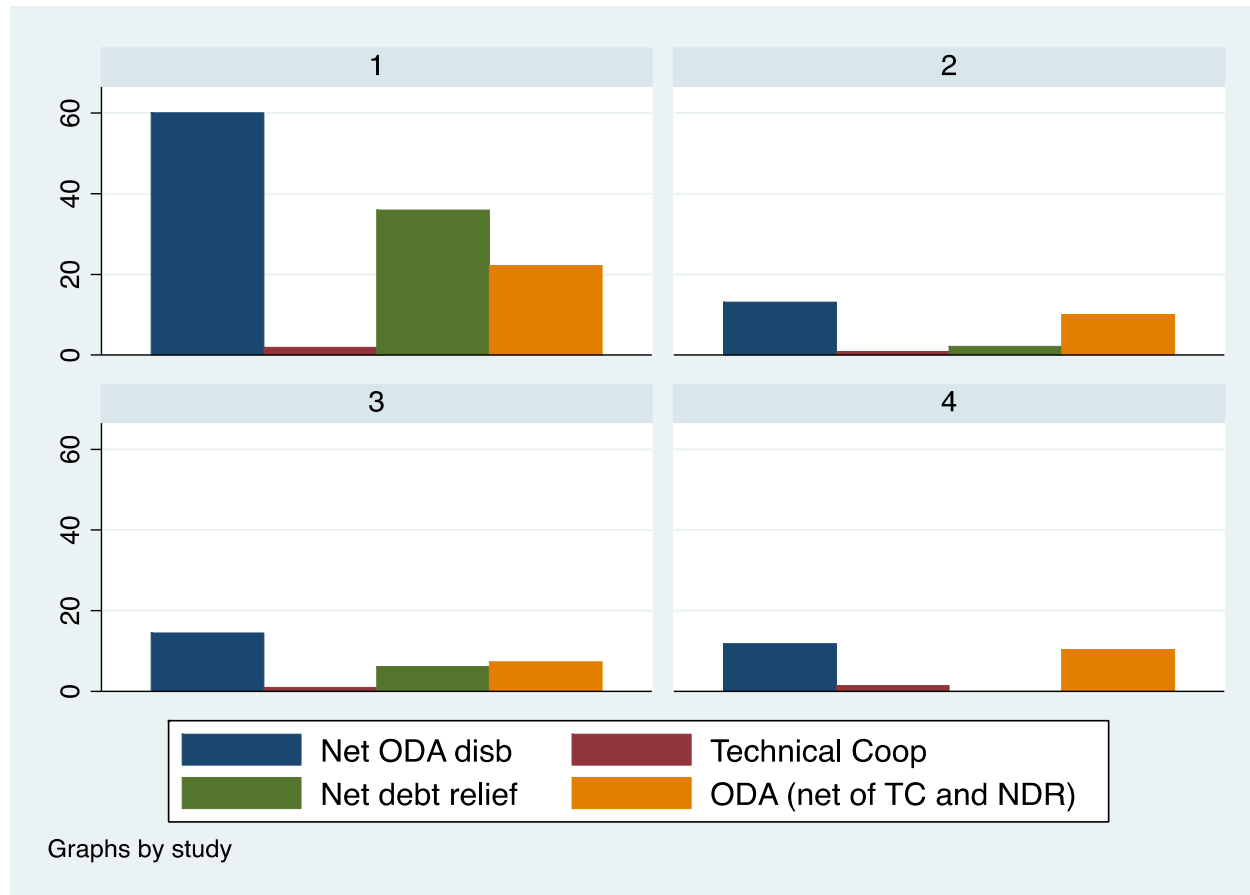
Methodology and Empirical strategy

Based on the findings of our panel analysis, we identify relevant issues to explore through the case studies

- Characteristics of Aid flows (level, composition, complementarity with Remittances, the exposition to shocks)
- International Markets Conditions (Changes in price level of imports, external debt terms by official creditors, capital flight)
- Government Spending and Central Bank's Monetary and Exchange rate policies

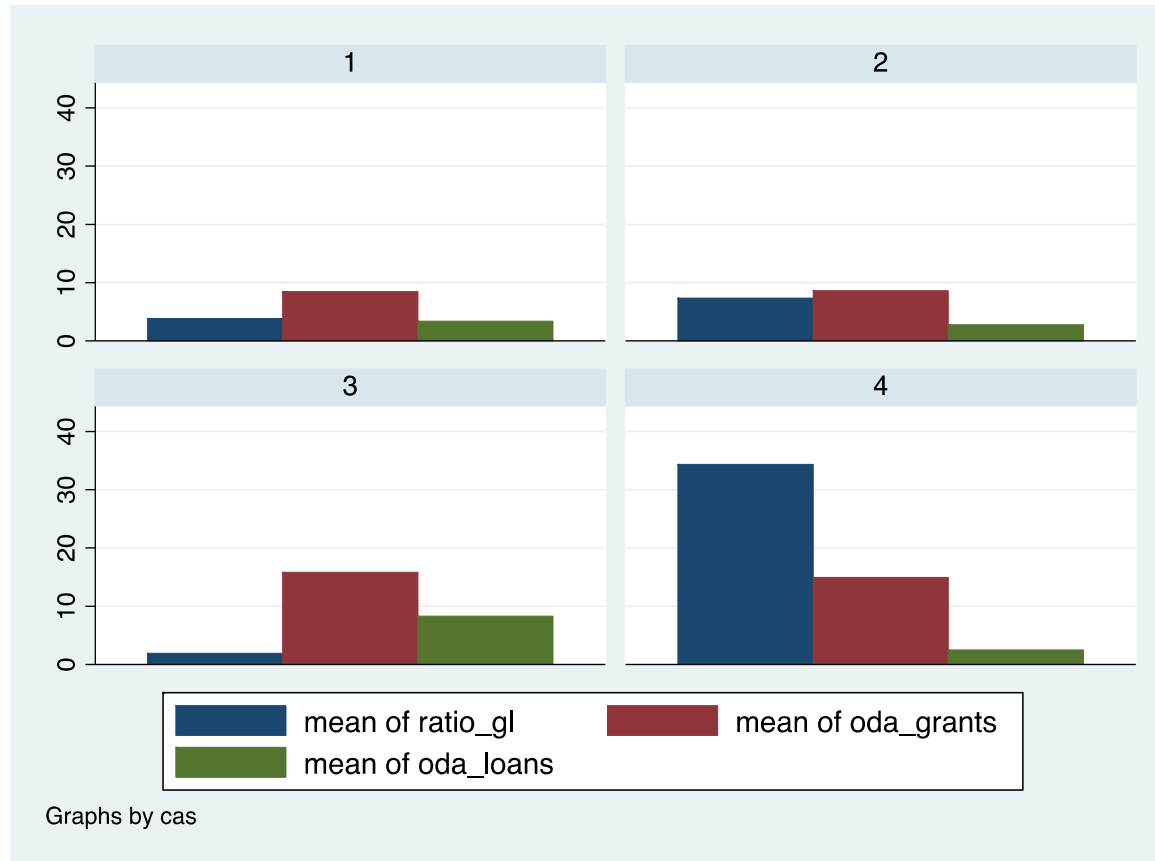
Case studies: Preliminary results

Relative Aid Dependence and stabilizing profile



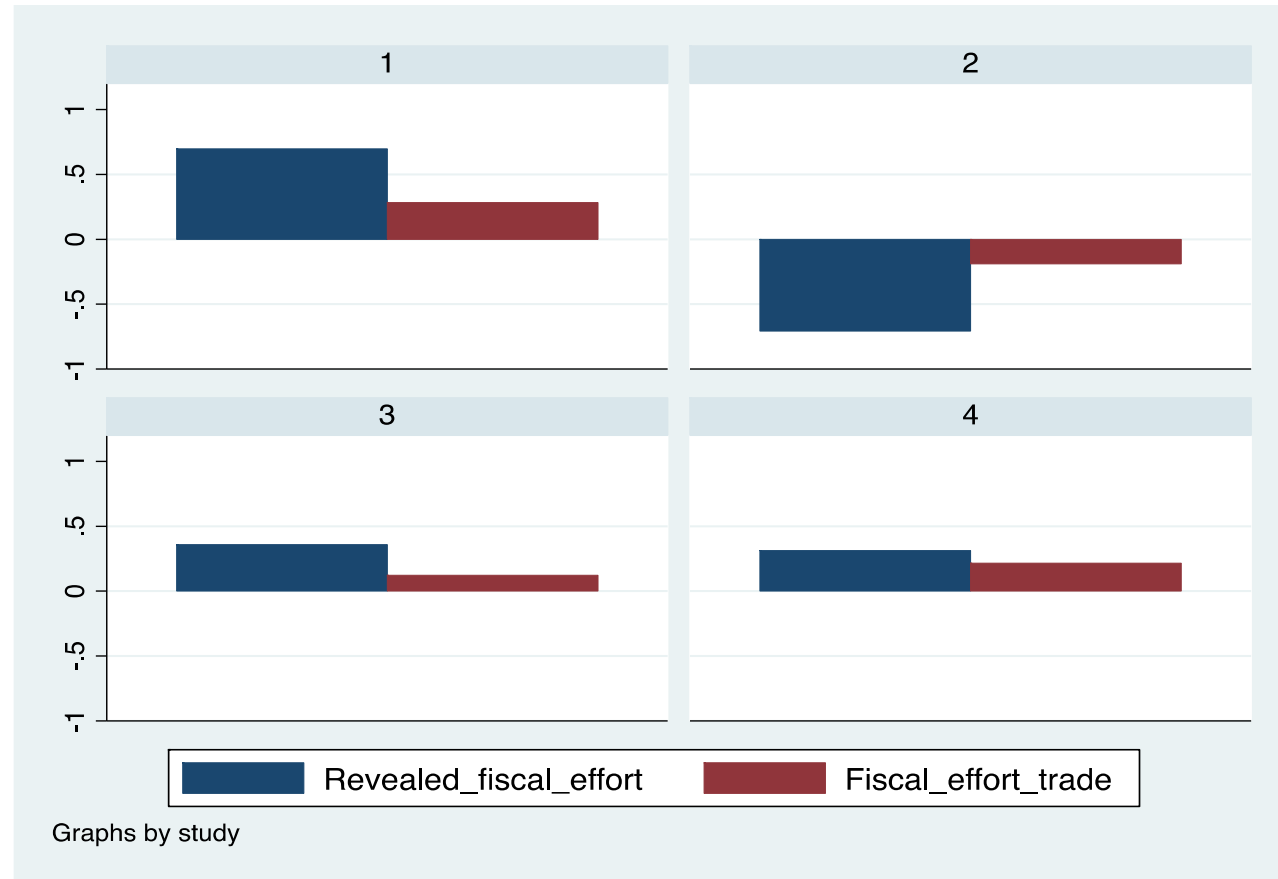
Case studies: Preliminary results

Aid Loans vs. Grants: Aid Grants more destabilising?



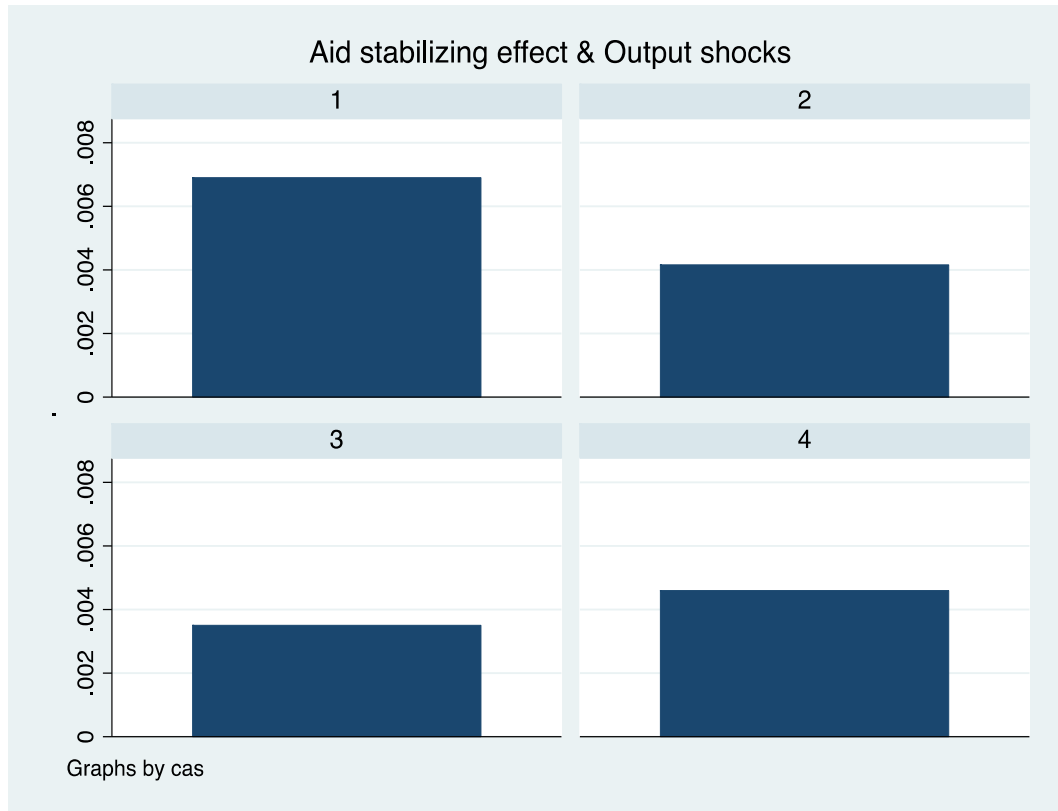
Case studies: Preliminary results

Aid Stabilising effect and Domestic Resource Mobilisation



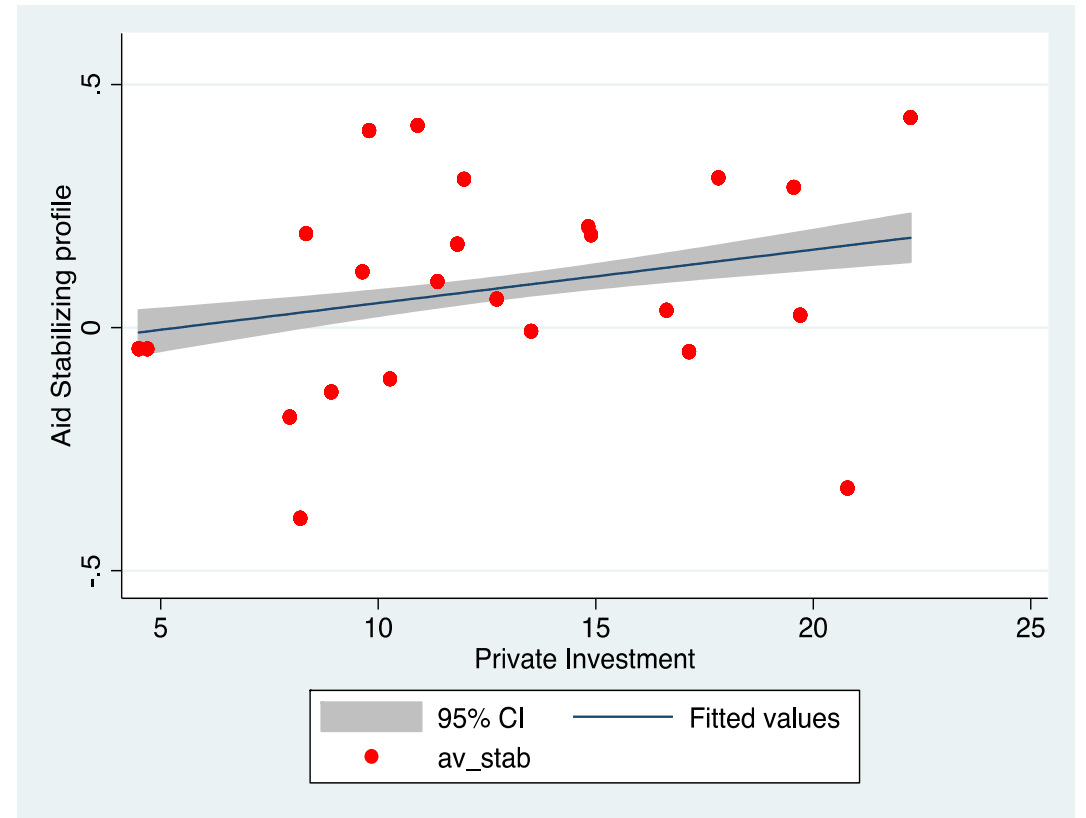
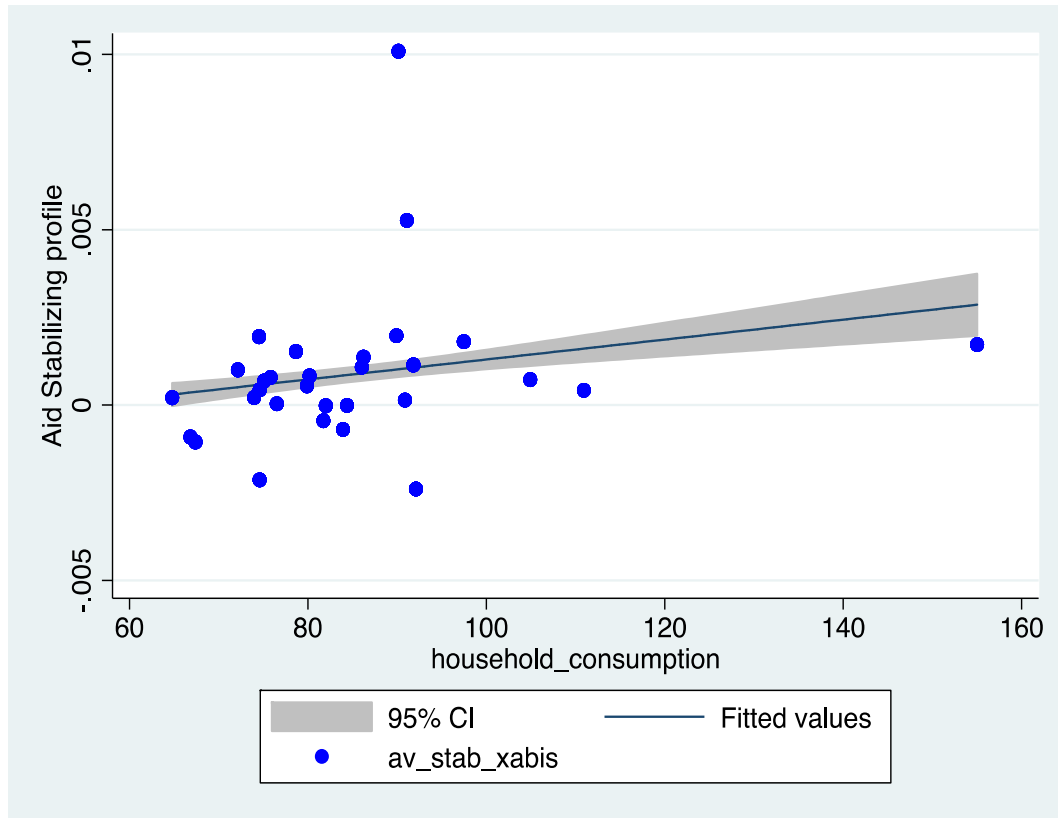
Case studies: Preliminary results

Exposition to shocks



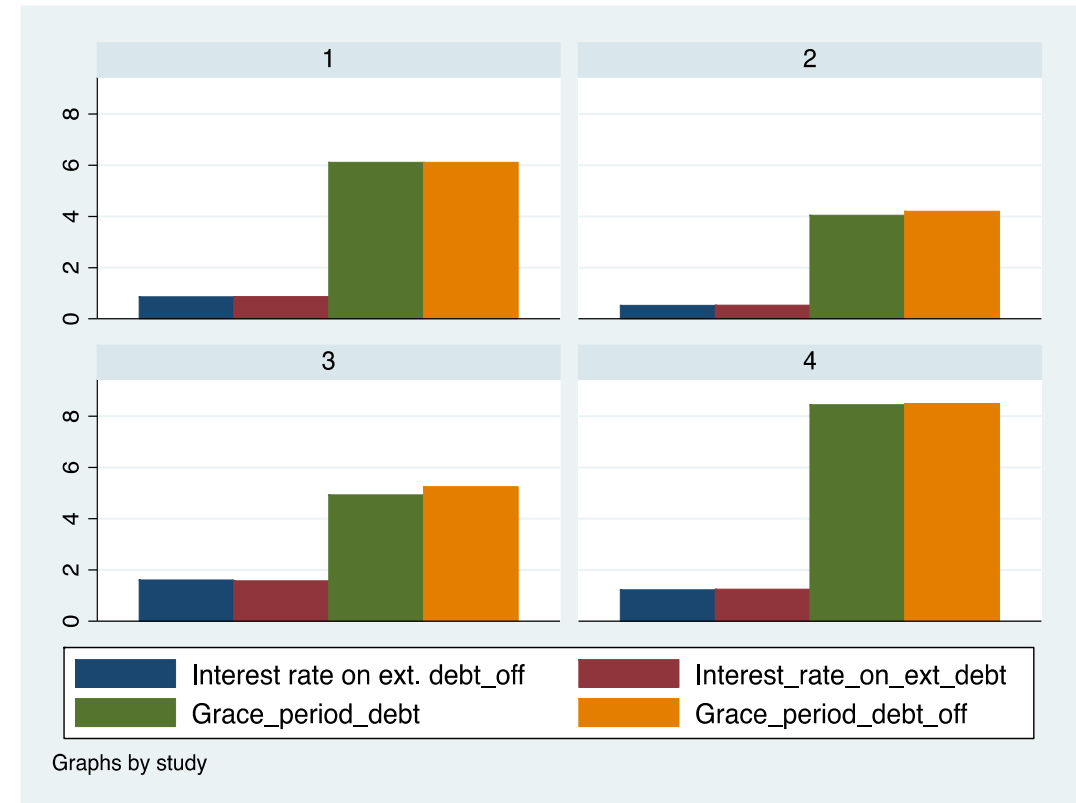
Case studies: Preliminary results

Aid Stabilizing effect and Remittances : Household Consumption and Investment



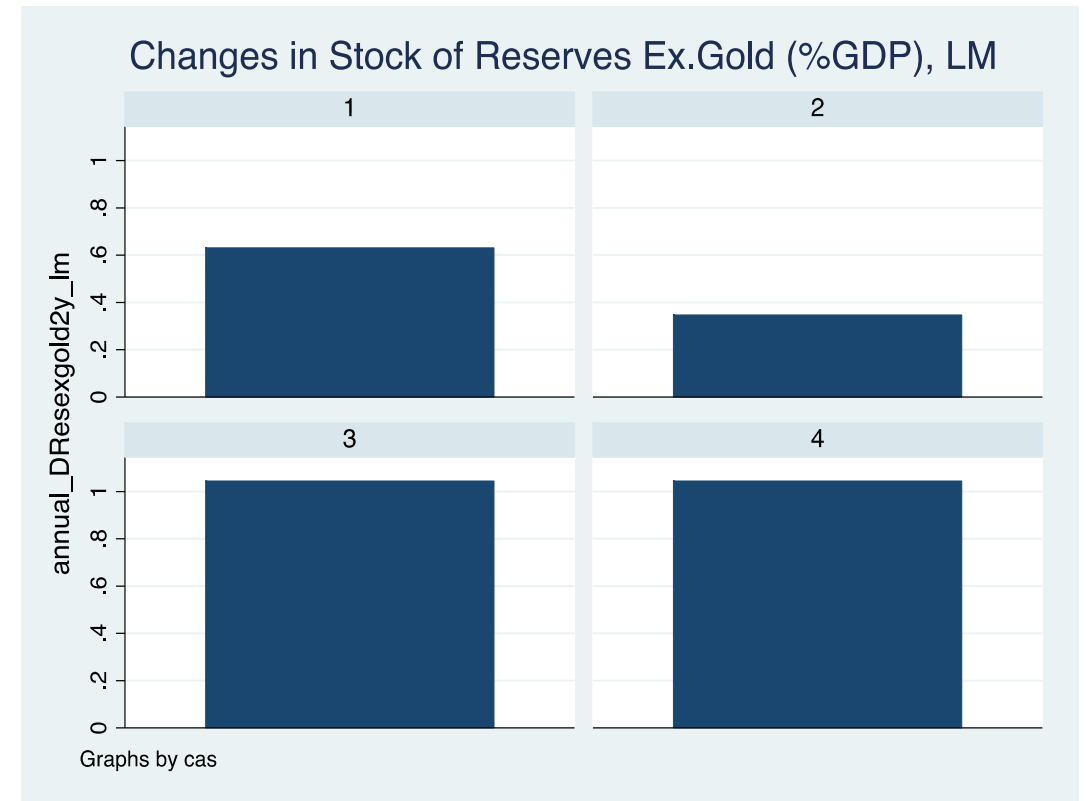
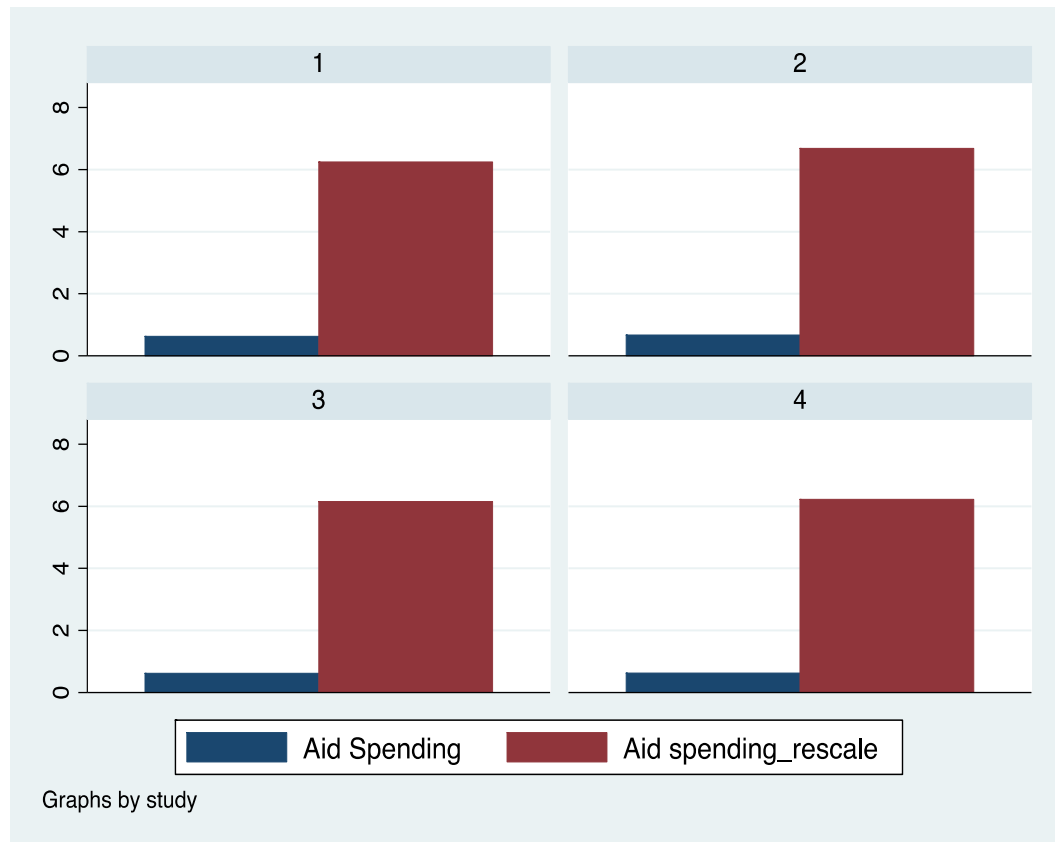
Case studies: Preliminary results

Defavorable Conditions on International Markets: Price of Imports and External Debt terms



Case studies: Preliminary results

Inconsistency between Government Spending and CB Monetary and Exchange rate Policies



Case studies: Issues to explore

- Capital Controls and Macroprudential policies
- Analysis of stabilizing profile of aid considering « Commodity price » cycle

