Summary - The effects of EU aid on receiving and sending countries: A modelling approach

Dawn Holland and Dirk Willem te Velde[1] for ONE

The European Union is currently discussing the European Commission's future development aid budget as part of the Multiannual Financial Framework (MFF) over 2014-2020. However, these negotiations have largely neglected a discussion on the economic effects of EU aid for both donor and recipient countries. This study is the first attempt to quantify such effects.

The report, carried out for ONE by the UK-based Overseas Development Institute (ODI) and National Institute of Economic and Social Research (NIESR) simulates the impact of EU aid to the poorest, as channelled through the European Development Fund (EDF) and the Development Cooperation Instrument (DCI) to developing countries. Over the seven year period 2014-2020, the European Commission proposes funding for these instruments at €30 billion, and €21 billion respectively, adding up to a total of €51 billion.

The report concludes that over the 7 year period of the next EU budget, under a reasonable set of assumptions, if the €51bn investment in development aid is channelled effectively it will be completely recouped by EU taxpayers, and the effects on the ground give a clear return on investment. In that time European and global GDP levels will receive a boost of almost 0.1 per cent and over 0.2 per cent respectively as a result of this aid, with much stronger benefits accruing to the aid recipient regions.

The main findings of the report are:

- The costs of Europe's €51 billion of aid to the world's poorest over the period 2014-2020 would be more than paid back by 2020.
- At the EU-wide level, the level of output (GDP) is expected to be almost 0.1 per cent higher by 2020 or €11.5 billion as a result of the aid programme. Output at the global level is expected to be over 0.2 per cent higher over the same period.
- Output in Sub-Saharan Africa would grow by an additional 2.5 per cent by 2020 as a result of the aid.
- If the planned €21 billion of aid that mainly targets sub-Saharan Africa (under the €30 billion of the total EDF) is directed towards trade enhancing and social infrastructure, this can be expected to lead to a decline of around 6 per cent in the costs of exporting or importing goods and services. This would act as a significant boost to trade for both donor and recipient countries.
- In this case, export and import prices in all the EU donor countries are also estimated to fall by between 0.3-0.9 per cent.
- The aid flows are also expected to reduce the tax burden in the EU. In over half of countries, tax rates would be expected to decline as a result of aid flows.

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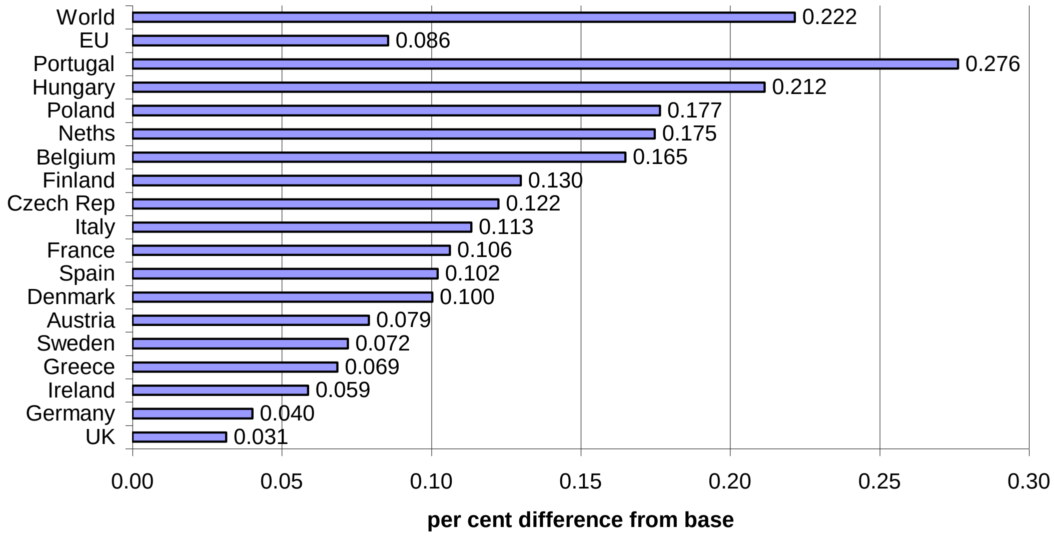
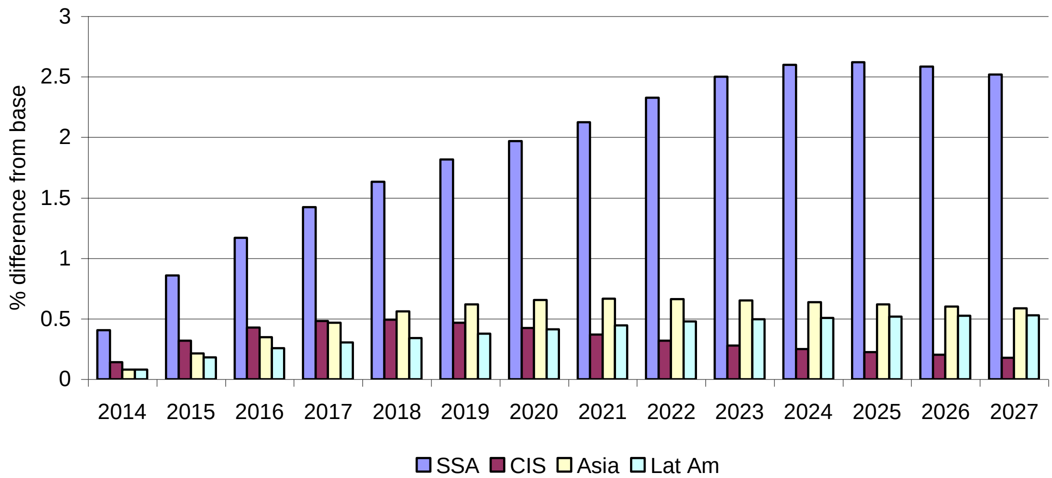
Expected impact on GDP in donor countries and world, 2020



Expected impact of aid flows on GDP in recipient regions



The impact on Sub-Saharan Africa is expected to be significantly greater than the other regions. After 10 years, we would expect the level of output in Sub-Saharan Africa to be 2.5 per cent higher than it would be without the aid. Output in the other regions would be expected to rise by ¼ - ¾ per cent after 10 years.

Note on the model, model simulation and model assumptions:

The simulations were carried out using the National Institute's Global Econometric Model, NiGEM. The NiGEM model has been in use at the National Institute for forecasting and policy analysis since 1987, and is also used by a group of about 40 model subscribers, mainly in the policy community, including the Bank of England, the ECB, the Bundesbank, the OECD and the IMF.

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