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Impact of Foreign Aid on National Development

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ABSTRACT: Global concerns to eradicate poverty is a basic need for aid intervention. In recent years aid intervention in Nigeria has increased tremendously. The impact of aid intervention on National Development cannot be over emphasized. Foreign aid has direct forms such as economic aid, social aid, food and emergency aid with each having different motives. The focus of this study hinges on the impact of foreign Aid on National Development. Qualitative approach was adopted as method of data collection. The finding corroborate that though aid is not gratis it has more positive impact on national development.

KEY WORDS: *Global, Poverty, aid, Foreign, national development.*

I. INTRODUCTION

Foreign aid plays very essential role in the overall development of a country provided it is utilized properly. Due to the scarcity of economic resources and others natural constraints every country needs the sufficient amounts of foreign funds in shapes of foreign aid. Generally foreign aid is granted to reduce the budget deficit, trade promotion and strategic considerations. Foreign aid can affect the macro and micro policies of the host country.

Nigeria has been receiving foreign aid from many countries and international monetary agencies. It is also a living fact that Nigeria has been a graveyard of development projects financed by the many international donors. In principle foreign aid could be a major source of capital, fueling the growth of developing countries and helping to promote human development. To fulfill the two gap theory developing countries have to rely on foreign aid. These two important gaps are the import-export gap and saving – investment gap. Nigeria like any other developing, third world nation has been a recipient of foreign aid since her independence in 1960. This aid has been in the form of grants, tied aid, project aid and huge inflows intended to keep the foreign exchange reserves at a safe level to cope with industrialization related liberal import policy. Foreign aid plays very essential role in the overall development of a country provided it is utilized properly. Due to the scarcity of economic resources and others natural constraints every country needs the sufficient amounts of foreign funds in shapes of foreign aid. Generally foreign aid is granted to reduce the budget deficit, trade promotion and strategic considerations. Foreign aid can affect the macro and micro policies of the host country. In principle foreign aid could be a major source of capital, fueling the growth of developing countries and helping to promote human development.

Evolution of Foreign Aid:

As the large and ever growing body of literature on foreign aid documents, two important developments – political factors and progress of development thinking – have made crucial impact in the evolution of modern era foreign aid policy (Hjertholm and White, 2000 and Kanbur, 2006). Each of these will be discussed in turn. If the evolution of development thinking has been more complicated and non-linear in nature. The CRS was established in 1967, jointly by the OECD and the World Bank, to supply data on indebtedness and capital flows. Over the years the CRS was developed and its aid activity database has become internationally recognized source of data on geographic and sectoral breakdown of aid and widely used by interested parties; including researchers, in the field of development. Geopolitical factors behind international aid were the Cold War until 1990s, the collapse of Soviet Union, and the events of September 11, 2001. The origins of modern foreign aid was launched in the aftermath of the Second World War.

The Marshall Plan, which represented US bilateral assistance to Europe, the establishment of the United Nations and the Bretton Woods conference that created the International Monetary Fund (IMF), which represented the multilateral foreign assistance – played important roles in early stages of modern era international or foreign aid. Certainly, the objective of these major developments was reconstruction of war-ravaged Europe. The success of the Marshall Plan provided the impetus for turning the focus to developing countries, beginning with the World Bank's first loan to Colombia in 1950 and the United States Act for International Development of 1950. This act established USA's foreign aid policy to support the efforts of the peoples of developing countries to develop their resources and improve their welfare (Ohlin, 1966 and Wolf, 1960). Further, the inaugural address of President Truman in 1949 enunciated a stance on aid for economic development to poor countries by rich nations that foreshadowed much of what followed in the analysis below.

For example, in the 1970s, foreign aid focused on poverty and "basic human needs", such as health and education. This was consistent with global development trends, particularly shifts in the priorities of bilateral and multilateral donors. For example, the United States established the International Development and Food Assistance Act 10, which instructed that 75 percent of food aid should go to countries with a per captain come less than $300. This period also marks an important shift in U.S.Foreign aid delivery. USAID shifted the structure of its aid from large transfers of money to foreign governments and financing of infrastructure to sharing technical expertise, providing commodities and developing community-based distribution systems that bring family planning information door to door. For example, USAID's Office of Population began reproductive health training and international surveys, such as Demographic and Health Surveys, in 1972. Later, the advent of balance-of-payment problem and the emergence of the external debt crisis in the early 1980s shifted the focus of international aid to macroeconomic reforms and market liberalization. Both multilateral and bilateral donors focused on broad-based economic growth, trade, financial systems, and the promotion of market – based principles to restructure macroeconomic policy gave the IMF and the World Bank (hence the so-called "Washington Consensus") a preeminence they had not enjoyed before. Another important event in this period was the rise of non-governmental organizations (NGO) as agents in foreign aid delivery. At this time, bilateral donors agencies, such as USAID and DFID further removed from the implementation of foreign assistance projects and began to channel their resources through NGOs. This trend became consistent and the number of NGOs involved in aid delivery has been increasing ever since. For example, USAID currently works with more than 3,500 companies and 300 private voluntary organziations. The end of the Cold War in the 1990s also caused three important changes in the foreign aid industry. First, the countries of Eastern Europe and the former Soviet Union reemerged as aid recipients. Second, poverty reappeared on the agenda of donor agencies, impact due to rising criticism of the macroeconomic and structural adjustment policies of the 1980s and early 1990s and the deterioration of socio-economic conditions in transition countries of Eastern Europe and the former Soviet Union (Milanovic 1998). The critics of the policies of the 1980s found their most effective voice in reports funded by UNICEF such as "The State of the World's Children" (Grant 1990) and "Adjustment with a Human Face" (Cornia et al, 1981). The turning point for poverty reappearing on the agenda of donor agencies was the 1990 World Development Report (World Bank 1990), which designed the "New Poverty Agenda". Third, although still inconsistently applied, donors started to show serious concerns about governance in recipient countries. In this new environment, some of previously important recipient countries became no longer so, and donors began awarding or withdrawing aid on the basis of perceived quality of governance. This was quite different from the Cold War period, when donors happily supported any "friendly regime" without giving much consideration to the quality of governance. It is too early to get a clear view of the evolution of foreign aid in the 2000s but there are some clear differences before and after 2000.

II. DETERMINANTS OF DONORS' AID ALLOCATION POLICIES

While studies of aid effectiveness have focused on economic development, do donors allocate foreign aid aiming to promote economic development and welfare in recipient countries? In other words, do donors allocate aid according to the needs of the recipient countries or according to their own interests? The review of the aid allocation literature suggests that donors seem to be neither entirely altruistic nor completely self-serving, i.e., donors' aid allocation aims to promote their own interests as well as oriented towards the needs of recipient countries. Four broad factors seem key in determining donors' aid allocation decisions: Recipient needs. It appears that promoting economic development and welfare appear crucial for most of the donors' in making aid allocation decisions. Donors' strategic and political interests; Most of the variation in aid flows can be explained in accordance with donors strategic assessments of changing international situation. Donors' economic interests also explain a significant part of the variation in foreign aid flows, i.e donors allocate some aid with the aim of expanding their own markets, creating sources of cheap imports from developing countries, and protecting foreign investments of their private companies. Recently, some donors started focusing on good governance and allocating more aid to countries with good performance on the various aspects of good governance. A review of the aid allocation literature leads to the following observations.

Firstly, while most empirical studies do not explicitly present the theoretical model embodied in their regressions, it is possible to incorporate them into the theoretical framework proposed by Dudley and Montmarquette (1976) and later extended by Trumbull and Wall (1994). Therefore, their frame work is presented here. The model is based on the standard microeconomic theory of constrained utility maximization and tries to explain bilateral donors' two decisions; first, whether or not to give aid to a given developing country (eligibility stage), and second, how much aid to grant given a positive decision had been made in first part (level stage). The model assumes that there are only two goods in donors' utility function: Impact of foreign aid and the other good. The donor maximizes the relative impact of its aid on the recipient country, as measured by the ratio of the per capital aid to the per capital income, weighed by the size of receipient's population. The main assumptions of the model are as follows: donor country may expect that the recipient country will behave more favourably toward donor country by supporting donor's national political interests, the recipient country will confer economic benefits towards the donor by buying more of the products from the donor country, the lives of people in the recipient country will be better because of donor's assistance (altruistic vision). While the first two assumptions refer to donor interests, the third assumption refers to recipient needs. By solving the utility maximization problem subject to budget constraint, Dudley and Montmarquette (1976) derive two econometric specification to test the relative importance of various factors in donors' aid allocation decisions. The mode developed by Dudley and Montmarquette (1976) aimed to explain individual donor's aid allocation decision assuming that different donors have different subjective measures of the impact of aid to a recipient country. Later Trumbull and Wall (1994) extended the model to allow optimization by multiple donors assuming that all donors have the same subjective measure of the impact of aid to a recipient country. Later Trumbull and Wall (1994) extended the model to allow optimization by multiple donors assuming that all donors have different subjective measures of the impact of aid to a recipient country. Later Trumbull and Wall (1994) extended the model to allow optimization by multiple donors assuming that all donors have the same subjective measure of the impact of aid to a recipient country. In this model, similarly to Dudley and Montmarquette (1976), a donor maximizes the weighted sum of the total impacts of its official development assistance on all recipients subject to its aid budget. Second, an empirical analysis of the determinants of donors' aid allocation policies indicated some identification issues. Evidence shows that individual donors provide a positive amount of aid to some recipients and nothing to others. Also, larger donors (USA, Japan, UK, France) tend to give some amount of aid to most of the recipients, while smaller donors (Denmark, Finland, Ireland, etc0 tend to focus on fewer recipients (Dudley and montmarquette (1976), Alesina and Dollar 2000, neumayer 2003). As Neumayer (2003 and others pointed out, the exclusion of some countries from the recipient list by some donors makes the dependent variable, aid, only partly continuous with positive probability mass at the value of zero. Since OLS depends on the assumption that the expected value of the dependent variables is linear relative to the independent variables, this creates a problem for standard OLS estimation. The existing literature suggests using more sophisticated estimation techniques, such as the two part model (Dudley and Montmarqjuette 1976, Apodaca and Stohl 1999, Svensson 1990, neumayer 2003, etc) and the Tobit model (Alesian and Dolar 2000, Alesina and Weder 2000) to overcome this problem. Third, nearly all reviewed studies control in one way or another for donor interests and recipient needs in their empirical analysis of donors' aid allocation decisions.

III. BENEFITS AND COSTS OF FOREIGN AID:

Prominent economists and research scholars share different opinions about the impact of foreign aid to host country's macro and micro policies. According to white (1992), Mosley (1987) and Cassen (1986) foreign aid plays very important role at the micro level leading to national development. According to Sargent, Thomas (1993), Gang and Khan (1986, 1991), and Khan (1994, 1996), Foreign aid plays very little impact on the macroeconomics policies due to the complexity and constraints facing by the host countries. Foreign aid plays very important role in the development of a country and its benefits are given below:

- According to Chenery and Bruno (1962) and Chenergy and Strout (1966) foreign loans and assistances bridge saving gap. Foreign aid/loans supplement domestic saving and help in bridging the resources gap.
- According to Lance Taylor (1993), Bacha (1984) foreign aid pals pivotal role to fulfill internal and external balances.
- Heller (1975) Taylor 1993, pp. 11 – 12). Increase productivity of various economic sectors.
- Cashel-Cordo and Craig, 1986; Booth, (1988) Increase in tax collection Binh, Tran-Nam and Mark McGillivray, (1993). The foreign assistance helps in the establishment of industrialization in the country. The flows of technical knowledge improve the quantity and quality of manufactured goods and makes them available at lower prices to the domestic consumers.
- Foreign aid helps in increasing marginal productivity of labour in the recipient country. The real wages of the workers are increased by the induction of foreign aid.
- Foreign aid stimulates domestic enterprises. The firms avail of the benefits of external economies like that of training of labour, introduction of new technology, new machinery Foreign aid plays very important role in the reduction of poverty and other socio-economic problems and efficient economic institutions and macro-economic and fiscal policies in the developing world are the key to utilize the flows of foreign aid properly. Good governance and quality economic policies may increase the chances of bright future for Nigeria, the future that will be free from poverty, economic dependency, political exploitation, and scarcity of the resources (Richard, & Robert, 1973).

The Cost of Foreign Aid to Recipient Country:

The cost of foreign aid is very heavy on the recipient country if it is not utilized properly. It has been observed that most of the developing countries including Nigeria are not fully utilizing the foreign aid.

- The burden of debt servicing increases all the time.
- The tied loans given to Nigeria tends to increase the inflation rate.
- Increase the unwanted political exploitation.
- Unsuited economic conditionality (Kamath, 1995). Role of Global Foreign Aid in Post-Cold War Era Political ideology, foreign policy, commercial interests and strategic importance were the main causes for the granting of foreign aid in the post and especially after the World War II. In many cases the foreign aid was granted specifically to stop the onward March of the Communism in the world. Similarly, aid from socialist governments was motivated by a desire to promote socialist political and economic system. Furthermore, a number of donors supported former colonies in order to sustain their former economic domination and political supremacy. In the beginning or the post-cold war period foreign assistance / aid had twin objectives.

These two objectives are given below:

The first objective was to promote long-term growth and poverty reduction in developing countries; the underlying motivation of donors was a combination of kindness and a more self-interested concern that, in the long run their economic and political security would benefit if poor countries were growing.

The second objective was to promote the short-run political and strategic interests of donors. Aid went to regimes that were political allies of major Western powers mostly NATO. Bolivia and Zaire received U.S. aid, Partly for strategic reasons. But after the Cold War, foreign aid was frequently used to maintain or extend the strategic interests of the major powers i.e. U.S.A and USSR. To reduce the budget deficit, trade promotion and strategic considerations. Foreign aid was also granted on the account of environmental spending, humanitarian relief, peacekeeping and the promotion of political transitions to democracy (Alesiana & Dollar, 1998).

IV. CONCLUSION

Foreign aid contributed new ideas about development policy, and training facilities for public policy makers, and finance to support financial and social reforms and an expansion of public services. Foreign aid is granted to reduce the budget deficit, trade promotion and strategic considerations. Foreign aid was also granted on the account of environmental spending, humanitarian relief, peace keeping and the promotion of transitions to democracy. Foreign aid fails as a development policy because it destroys the incentives of the market place and extends the power of ruling elites. Because it leads the developing countries away from the free market, it actually increases their level of poverty. On the other hand, the alternative policy of free trade will give the private sector of the LDCs an opportunity to expand and flourish. It must be emphasized that free trade alone will not solve all the problems of developing countries’ poverty. Free trade only increases the opportunities of the less developed nations. It will not eliminate the shackles of government regulation and intervention that dominate developing countries’ economies. That task can only be done by the people themselves. Yet, eliminating foreign aid and instituting free will at least encourage developing countries to develop institutions such as private property rights and free markets which will lead to growth and prosperity thereby, leading to national development.

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