

FOREIGN AID: PROS, CONS AND IDEAS TO IMPROVE THE RESULTS IN THE WORLD*

COOPERACIÓN INTERNACIONAL: PROS, CONTRAS E IDEAS PARA MEJORAR LOS RESULTADOS EN EL MUNDO

Carlos Alberto Prieto-Valero^a

Abstract

The paper analyses the situation of development aid in the world. The study uses data from a period of 50 years to show information such as main donors, receivers, goals and amounts of money delivered in foreign aid. The paper will present both positive and negative arguments regarding this topic using a thorough review of bibliographic sources. The scope of the paper will not be to support a position, but to propose ideas and present alternatives to improve the efficiency of economic aid. Also, it will present the advances that international institutions are implementing in order to enhance their effects in the world.

Keywords

Growth, Foreign aid, Development, Effectiveness.

Resumen

El artículo analiza la situación de la cooperación internacional en el mundo. El estudio utiliza datos de un período de 50 años para mostrar información acerca de donantes, receptores, objetivos y cantidades de dinero entregadas en ayuda internacional. Usando una revisión exhaustiva de las fuentes bibliográficas, el documento presenta argumentos positivos y negativos con respecto a este tema. En el alcance, no trata de apoyar una u otra posición, sino proponer ideas y presentar alternativas para mejorar la eficiencia de la ayuda económica. Además, muestra los avances que las instituciones internacionales están implementando para mejorar sus efectos en el mundo.

Palabras clave

Crecimiento, Cooperación internacional, Desarrollo, Efectividad.

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^a Student at the Master of Science in Economics of the Friedrich Schiller University in Jena, Germany. Lecturer at the Volkshochschule Jena and Kreisvolkshochschule Saalfeld-Rudolstadt. Email: Capvalero@hotmail.com

Introduction

The mixed results on the effectiveness of foreign aid observed in hundreds of scientific papers, studies, books, lectures, articles, among others, makes questionable the way in which countries, and especially the Organization for the Economic Cooperation and Development (OECD), have been controlling the economic aid for the Less Developed Countries (LDC) during the last 50 years. Different scholars such as Burnside and Dollar (2000), Dalgaard et al. (2004), Dowling and Hiemenz (1982), Gomanee et al. (2003), Gupta and Islam (1983), Karras (2006) and Han-sen and Tarp (2000), Papanek (1972), argue that there is a positive or direct impact of development aid on growth; while others like Boone (1996), Bräutigam and Knack (2004), Jense and Paldam (2006), Mosley (1980) and Mosley et al. (1987), claim that there is a negative or inverse effect of aid on growth. The necessity to look over the effectiveness of aid is urgent and requires the support of institutions, politicians, people, NGOs, social leaders, presidents, international entities, among others, to generate the desired outcomes that are lined up with the Sustainable Development Goals for 2030.

The structure of the document is as follows: The first and second chapter introduce the reader into the conceptual and historical framework of the

topic, presenting the notion of Official Development Assistance (ODA) given by the OECD to measure the foreign aid and its evolution over the last 60 years for donors and receptors. The third and fourth chapter illustrate the methodology used in the current research, followed by an exhaustive analysis of arguments in favor and against foreign aid, giving the opportunity to the reader to evaluate different points of view from the specs of several authors that have worked in the field for years. The fifth chapter pretends to create a point of reference on possible solutions to improve the current experience of aid in the world. To conclude, a reflection about the urgency and importance of rethinking the current aid with some conclusions of the article, will be presented.

Theoretical framework: An introduction to the concept of Official Development Assistance (ODA)

Foreign Aid is a concept often used by people, especially in Government and media, to define the financial or technical help provided by one country to another one to support social and economic development or to respond to a disaster (Wells, 2015). The economic literature recognizes 5 types of foreign aid: Food aid, tied and untied aid, technical aid, conditional and unconditional aid, project or program aid and debt relief. It is important to clarify that the terms "International

cooperation", "Development aid" and "Foreign aid" are often used as synonyms in the economic literature. This is because throughout history, the foreign aid, sometimes came in the form of cooperation between nations and sometimes in the form of unconditional aid, which made the concepts valid depending on the author and the historical background.

The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) established a tool to quantify these 5 types of foreign aid called "Official Development Assistance" (ODA), used to measure how well the efforts of donor governments, which deliver the financial or technical assistance, meet international development objectives. According to Murad and Zeb (2016), the OECD implemented ODA as the "gold standard" of foreign aid since 1969 and it remains the most important source of financing in terms of international cooperation. Moreover, the ODA is used to measure the amount of foreign aid given by donor governments for international development reasons. Finally, ODA also enables to evaluate donor performance against aid obligations and allows partner countries and civil society to keep donors up to date.

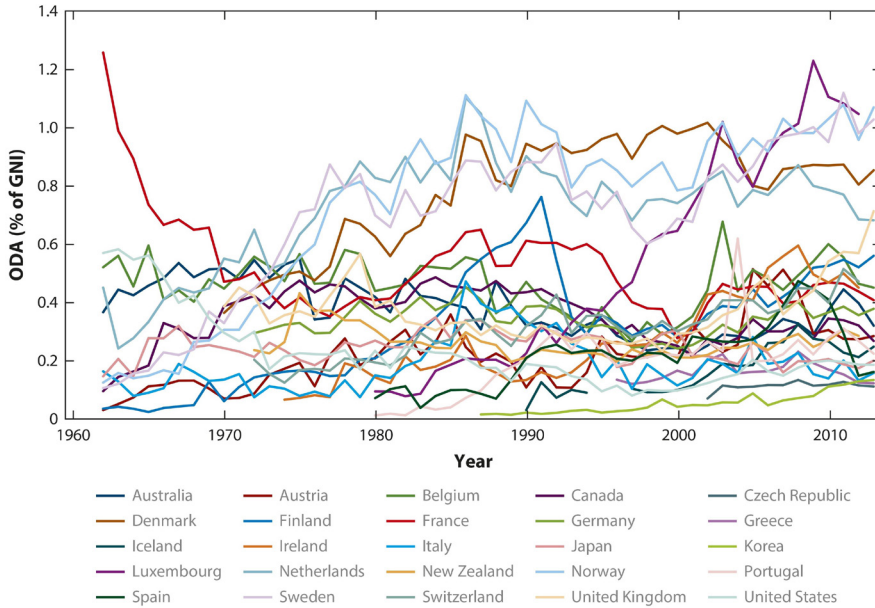
Theories regarding the effectiveness and importance of foreign aid will be presented in-depth in Chapter 4.

Historical framework: Understanding the foundations of development aid

According to Reci (2014), understanding the role of foreign aid in the promotion of development, requires that we first comprehend its history and objectives in the world.

For Qian (2015), since World War II, foreign aid has been one of the most important policy tools that high-income countries use to help low-income countries increase economic growth, improve population well-being, and facilitate institutional development. In 1970, the United Nations General Assembly issued a resolution that specified that rich countries should target to give 0.7% of their GNP to poor countries in the form of Official Development Assistance (ODA). During 1960 and 2013, about 3.5 trillion dollars (2009 USD) were given as foreign aid from rich to poor countries. Figure 1 shows that only 7 countries have reached the goal of 0.7% and from all OECD member countries, 19 have never reached this target.

Figura 1. Official development assistance (ODA) as a percentage of Gross National Income (GNI), 1960–2013

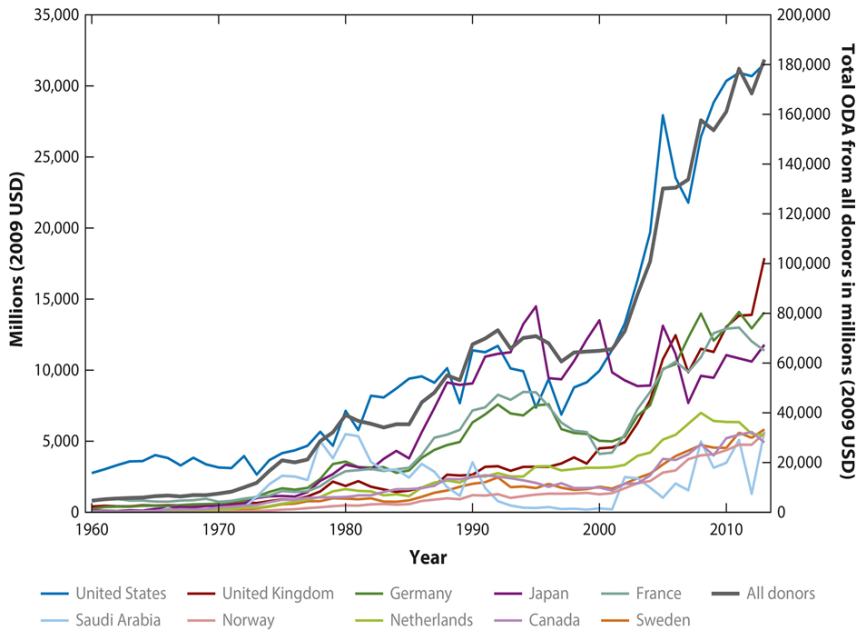


Fuente: Qian, 2015.

On the other hand, if the analysis is presented in monetary terms, the result is quite different as the size of the countries that play an important role here. Figure 2 shows the expenditures of the main 10 donor countries during the same period. In this new figure, United States appears as the country that gives the most on average. Another

historically relevant data is that until the 90s, the trend in total ODA was driven by Japan and European countries like Germany and France. After that, The United States has been driven the trend. It is also important to highlight the presence of Saudi Arabia, which is not a member of the DAC, among the top donors.

Figura 2. Total official development assistance (ODA) and ODA from the top 10 donors, 1960–2013



Fuente: Qian, 2015.

In addition, Table 1 shows the percentage of foreign aid distributed between the regions of the world during the last 40 years. The results should not be surprising, as it is well known that Africa (North, Middle East and Sub-Saharan together), received around 45% to 50% of the aid of the World, followed by Asia and Oceania, Latin

America and Caribbean, and finally Europe. Given the huge quantity of money put into foreign aid and the call from international policymakers to increase it even further, one can think that it is expectable that aid remains a subject of debate for academics, international institutions and policymakers in a permanent way.

Table 1. Historical distribution of Foreign Aid by Region (%)

Region	1986-1987	1996-1997	2006-2007
Sub-Saharan Africa	26.6%	23.4%	31.3%
South and Central Asia	12.9%	10.2%	10.5%
Other Asia and Oceania	18.2%	21.4%	12.7%
Middle East and North Africa	16.0%	12.7%	16.1%
Latin America and Caribbean	11.5%	13.3%	7.4%
Europe	2.5%	3.4%	3.6%
Unspecified	12.3%	15.6%	18.4%

Fuente: Ekanayake & Chatra (2010).

Methodology

This section reviews the ways of literature search used to locate and select relevant studies concerning the topic of foreign aid in the world used in this article.

Databases and documentary sources

The article was written with primary sources and a few secondary sources. Most of the documents reviewed were articles from peer-review journals, followed by books and some reports from international entities such as the World Bank. Different international databases such as Scopus, EBSCO, JSTOR, ELSEVIER, ScienceDirect, EconPapers, ResearchGate and Google Scholar were employed to collect many of the papers. Grey literature was not used in this article.

Search strategy

Information was searched through keywords using the previously presented databases. The thesauri used were: *Arguments in favor AND foreign aid, Arguments against AND foreign aid, ideas improve AND foreign aid, World Bank AND foreign aid, Theories AND foreign aid, ODA AND foreign aid, impact AND foreign aid, effectiveness AND foreign aid, economic growth AND foreign aid, effects AND foreign aid, Sachs AND foreign aid, and Easterly AND foreign aid.* This search strategy was carried out during the first semester of 2019

Selection criteria

Once the search results were obtained through the previous techniques, all the documents were passed through inclusion and exclusion filters. Only

studies that met the following criteria were accepted:

- To include documents in English only.
- To include articles with data on foreign aid from the last 60 years.
- To exclude papers published before 1970.
- To exclude articles that were not published in peer-review journals.
- Preference was given to studies with evidence of impacts in multiple countries and not just in one country.

Information classification

Once the documents were filtered under the previous selection criteria, they were categorized in 4 groups: Theoretical framework, Arguments in favor, Arguments against and ideas to improve foreign aid. At this point of the investigation, a complete reading of each article was made for its classification and extraction of relevant information. The conclusions and some important data were mainly taken for the sections of this article.

Literature review: A mix of opinions and perceptions but the same reality

In economics, according to Askarov and Doucouliagos (2015), there are two contending positions on aid. A view proaid, supported by Jeffrey Sachs, some academics and the United

Nations, who claim that foreign aid will give the big push to break down the low-income poverty; and a view that is skeptic about the impacts of aid, supported by William Easterly and other researchers that point out that aid has not proven to work after the last 40 years of large investments. The idea of the next segment is to present more extensively some of this arguments product of historical, empirical and political investigations considering these two trends.

Arguments in Favor of Foreign Aid

For Sachs (2005), it is our responsibility to help the poor and developing nations. The situation of many African countries shows that this could be overcome if they apply something called "Clinical Economics", where the aid can provide investments in areas such as agriculture, basic health, education, electricity and sanitation systems. Furthermore, Sachs says that the cost of providing this kind of aid is not as expensive as the world thinks and the benefits would be astounding, not only to guarantee that the countries could get out of the poorness situation but to create economic growth in the mid and long term.

Addison et al. (2005) demonstrate how aid to African countries, not only increases growth but also decreases poverty. In the same way, Isaksson and Kotsadam (2018) also conclude

that economic aid has the potential to decrease global income inequality by relocating resources from rich to poor countries, especially in Africa.

The meta-analysis of Doucouliagos and Paldam (2011) shows that both short-term aid and project aid have a positive effect on growth. Morrissey (2001) identifies numerous mechanisms through which aid can contribute to growth: It can proliferate human and physical capital investment; it can augment the capacity to import technology and capital goods; and it can increase capital productivity and encourage endogenous technical change due to the technology transfer; finally, aid can also increase growth by improving economic freedom, governance and democracy. Moreover, Fayissa and El-Kaissy (1999) and Hansen and Tarp (2000) conclude that foreign aid accelerates economic growth by expanding domestic capital formation. It can increase public investment, predominantly in infrastructure and in human capital.

Econometrical studies like the one made by Karras (2006), investigates the correlation between foreign aid and GDP per capita via annual data from 1960 to 1997 for a sample of 71 aid-receiving developing countries. He concludes that the influence of foreign aid on economic growth is positive and statistically significant. More specifically, he found that a stable increase in foreign aid by \$20 per individual ended

up in a permanent rise in the growth rate of real GDP per capita by 0.16%. In that sense, Clemens et al. (2012) also conclude that there are modest effects of aid on growth, as aid appears to have non-linear effects on growth, and there may be limits within which even large aid receipts can further increase growth in the typical recipient.

To conclude this section, it is crucial to present at least a short discussion about the efficiency of foreign aid under two conditions: good policy strategies and diminishing returns of scale. While authors like Guillaumont and Chauvet (2001); Hansen and Tarp (2000); Hudson and Mosley (2001); Lensink and White (2000); Lu and Ram (2001); Ram (2004) argue that aid can be effective without a complementary package of good policies in recipient countries; researchers like Burnside and Dollar (2000), argue that aid might have a positive impact on growth if they were systematically allocated toward countries with good policies. Collier and Dollar (2002) also confirmed their results and found that aid effectiveness depends on the policy environment and it is subject to diminishing marginal returns. For Collier and Hoeffler (2004); Dalgaard and Hansen (2001); Hansen and Tarp (2001); Hudson and Mosley (2001) and Lensink and White (2001), aid rises growth but in presence of diminishing returns, independently of a good or bad policy in the recipient country.

Arguments against Foreign Aid

On the other hand, for Easterly (2002), the real problem is the bureaucracy that creates a hostile environment for the aids from abroad. The international community is trying to respond to the difficult environment of these countries by means of “good intentions” while the bureaucracy controls the foreign aid. According to Schleifer (2009), aid stimulates corruption; promotes rent seeking at the expense of profit-seeking; benefits elites; comforts governments in donor countries and reduces efforts of market liberalization. Empirical studies like the one made by Dreher et al. (2008) and Kaja and Werker (2010) suggest that aid is given (not always but sometimes) for political reasons, confirming with it the affirmations of Schleifer (2009). In this regard, Griffin and Enos (1970) are right when they affirm that, unlike pure philanthropy, there are other reasons why foreign aid is given and donor countries judge its effectiveness, as individuals may be benevolent and dis-interested, but countries clearly not.

As it is appreciable, corruption and an unethical public administration are some of the typical problems in the field of foreign aid. Bräutigam (2000) found that aid could create a moral risk problem, whereby aid recipient governments take part in riskier fiscal behavior, knowing that they are likely to be rescued by donors. In that sense, Knack (2001) notes that the depen-

dence on aid can mess up institutional quality, deteriorate accountability, stimulate conflict over the control of aid funds and encourage rent-seeking and corruption. For Moyo (2009), a noted Zambian economist, aid is the single worst decision of modern politics. She argues that aid has encouraged kleptocracies, corruption, aid-dependency and a series of harmful economic effects and vicious downward spirals of development in Africa. For her, aid provides a windfall to governments, which can encourage extreme forms of rentseeking.

Another important trend on aid critics is the one that argues that it does not produce effects on growth. Researchers such as Doucouliagos and Paldam (2009), Easterly et al., (2004), Kosack (2003), Rajan and Subramanian (2008), Roodman (2007), among others, strongly defend the theses that claim, with historical and statistical data, that aid has no influence on growth. For instance, Boone (1994) argues that there is no significant correlation between aid and growth because, virtually, all aid goes to consumption. Years later, Boone (1996) confirmed his thesis using data from 96 countries between 1971 and 1990, finding that aid programs have not produced or correlated with the basic components that usually cause growth.

Naturally, some of the authors that criticize aid have counteracted studies from researchers that affirm that

aid produces positive effects. As an example, the results of Burnside and Dollar (2000) have been critically discussed between authors questioning their conclusions. One of those was Easterly et al. (2004) that noted that the results are fragile because adding extra data to their study produced doubts about aid effectiveness. Furthermore, they claim that economists and politicians should be less optimistic when they affirm that foreign aid will increase growth in countries with good policies. Jensen and Paldam (2006) also criticize the results of Burnside and Dollar (2000) as they replicate the model employing as much of the available data as possible, concluding that this “good policy” model is inconsistent.

How should a person take a wise and objective position on aid after reading this small overview of positive and negative arguments? The truth is that thinking about aid sitting in a presidential chair, a seat in the Congress, an office of an NGO or even a classroom of a university is clearly not enough for understanding the whole picture. In the long run, through the lens, you look at the issue and will have a position about it, but independently of your perception, the reality is still there. Every day there are hundreds of people in some developing countries suffering from the lack of basic resources, manipulation from the politicians of the official statistics, corruption, rent-seeking, resource deviating, among others. The constant of the optimistic studies is the

use of modeling, restricted statistics and some few positive results, that even being partially true, are clearly not the expected ones, considering the high investment from donor countries as it was previously presented in the section dedicated to understanding the foreign aid. Then it is important to review how to improve the situation, independently of the position in favor or against aid, and that is the purpose of the next section.

Reconsidering the foreign aid: Alternative ideas to achieve better results

Numerous researchers have suggested several ideas to improve the efficiency of foreign aid in the world. One way, according to Easterly (2002), could be to explore non-bureaucracy channels to try to reach the poor people, because the current methods that organizations like the World Bank have been using for several years, present a lot of problems of ethical administration, corruption and bureaucracy. In a similar sense, Collier (2007) recommends a model of “Independent Service Authorities”, which correspond to organizations that are autonomous from the government and can cooperate with the civil society to administer aid and public money, including the inspection from the public opinion and NGOs to decide how to maximize the output. Easterly (2005) also advocates the use of localized funds in municipal

or regional projects, instead of giving the money at a national level, asseverating that personalized schemes like this, help the world's poor more efficiently.

Likewise, a rigorous study made by the MIT professors Banerjee and He (2003) suggest some possible highly effective forms of aid to apply in the countries. Education vouchers for school uniforms and textbooks, subsidies given directly to families to be spent on children's education and health, deworming drugs and vitamin/nutritional supplements, HIV/AIDS prevention programs, indoor sprays against malaria, anti-mosquito bed netting, suitable fertilizers, clean water supplies, among others, are ideas that can improve the aid, when it is applied under normal conditions (no corruption, no bureaucracy).

It is also important to guarantee the quality and transparency of the information, especially in countries with high levels of corruption, as the numbers can show a completely different thing from the reality. Kharas (2011) suggests adopting a "regulation through information" approach, which has demonstrated its effectiveness in the case of European integration. Actually, at a global level, when the implementation of mandatory rules is problematic, the solution could be to offer and make transparent, appropriate, accurate and reliable statistics accessible. It can be used to recompense or sanction sin-

gular aid agencies according to their performances. This means to establish a strong culture of accountability within aid.

As a reaction to the major critiques in the field, the World Bank, the donor countries and institutions have advanced by rethinking the way in which they have been managing foreign aid. During the last 20 years, they have done five high-level forums and have created three new agencies (MCC, Global Fund, and Gabi). Each forum has focused on different issues but all of them have had the same purpose: increasing the efficiency of aid. The first one called the "Monterrey Conference (2002)", was in Mexico and was focused on aid effectiveness between developing and developed countries. The second was in Italy and was known as the "Rome Declaration (2003)", pointing the need for aid harmonization. The third one was the influential "Paris Declaration (2014)" that defined a coordinated agenda to include five pillars: alignment, ownership, harmonization, managing for outcomes and mutual accountability. According to Martini et al. (2012) and Burall and Datta (2008), this framework highly engaged the donor and the recipient in the aid administration to guarantee its effectiveness. The fourth was "Accra Agenda for Action (2008)" and was an initiative that shared the idea of South-South Collaboration. Finally, the fifth and most important forum was the "Busan Partnership (2011)",

which established a significant step in the path of promoting the quality of aid and development, presenting a change from aid to development effectiveness.

However, improving the effectiveness of aid depends fundamentally on the strong motivations that the donor and recipient countries have and how they can be lined up with the real objectives of aid. This is also subject to the degree to which aid is tied to capital projects rather than being spent in forms such as nutrition aid or debt relief, which do not necessarily have any development effect. The effectiveness of aid can also be determined depending on whether receptors use it to increase savings and investment rather than switch aid resources to consumption and other nonproductive purposes.

Conclusion

Banerjee and Duflo (2011) claim that there is a need for a radical rethinking of the way to fight poverty in the world. In their view, the hostile debate between Easterly and Sachs has missed the boat. Recently, there is a growing group of researchers that argue that this controversy cannot be solved by using aggregate data and cross-country regressions. The evidence, in their view, is quite simple: Some projects work and are effective in decreasing poverty and moving the domestic populations to self-sufficiency and prosperity, while others simply fail.

Maybe the question is not how aggregate aid programs have performed in the past, but how to evaluate more inclusively and realistically whether specific programs are effective. One challenge to assess the effectiveness of aid is that not all aid is intended to generate economic growth. Some aid is intended for humanitarian purposes; some may simply improve the standard of living of people in developing countries, and so on.

Bourguignon and Sundberg (2007) have pointed out that there is a need to go beyond econometrics and explore each case of success of development aid. There is a multiplicity of ways to achieve effective programs on aid (also because the aid in the world is dynamic and in permanent change). Understanding why aid sometimes works and some projects are successful while others are disasters, requires examining in detail specific country episodes. If we want to understand the complex ways in which official aid affects different economic outcomes, we need to dive into archives, analyze data in detail, understand the temperament of the main players and take into account old circumstances. This is a difficult subject that requires detective-like work but is probably a good strategy, considering that having a magic formula that performs well in every country as a rule, does not exist. Similar to humans, each country is special, and has its own features, history, politicians, culture, among others that

are crucial at the moment of planning a successful and effective foreign aid program.

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