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The Contribution Of Foreign Aid To The Reduction Of Poverty In Developing Nations?

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Abstract

Purpose: This paper seeks to examine the impact of foreign aid in poverty reduction in developing nations. It reviews the positive and negative impacts of aid in lessening poverty in evolving countries and the critical success factors that could serve as a blueprint for developing nations to adopt.

Methodology/Approach: The paper employs a critical review of extant scholarship, where empirical evidences on the positive and negative effect of foreign aid carried out from various countries were provided to support the claims of the studies.

Findings: The findings give insight into the viability of aid and identified some key critical success factors which comprised of good governance, recipient domestic policies, stringent conditionality of aid and interest of donor countries.

Research Implication: This paper provides a blueprint for critical success factors necessary for aid to be an effective tool for lessening poverty in the growing nations.

Originality/Value: This paper contributes to the existing article on the efficacy of aid in poverty reduction. It examines the positive and negative impacts of aid and identifies the critical success factors and propose these must be in place to enable growing countries reap the benefits of aid.

Keywords: Foreign aid, Poverty reduction, Developing countries.

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Introduction

The fact that even one individual does not have access to basic needs like good food, portable water and proper shelter is an indictment on the entire human race and should be a wake-up call that more needs to be done. Sadly, according to World Poverty Clock, an estimated 600 million men, women and children are living in abject poverty, a huge percentage of which reside in growing countries (World Poverty Clock, 2018). The United Nations defines acute poverty as "a condition characterized by severe deprivation of basic human ends, including food, safe portable water, sanitation facilities, health, shelter, education and information" (United Nations, 2018). To reiterate, these statistics mean that 600 million men, women and children lack basic human needs.

One strategy being utilized for decades to assist in reducing poverty in growing nations has been foreign aid. In 1970, the world's richest nations decided that they would all contribute 0.7% of the Gross National Income (GNI) as foreign aid to help developing nations overcome their developmental challenges, poverty being the foremost challenge (Organization for Economic Cooperation and Development, 2018). Since then, trillions of dollars of aid have been channelled to evolving countries, with $146.6 billion given in 2017 alone (OECD, 2018). An important question to ask is as follows: "to what extent all these trillions in aid actually led to the diminution of poverty in the beneficiary nations?"

Foreign aid has the history of being criticized bitterly by the developing countries (Niyonkuru, 2016). Aid is debatable in developmental economics. Despite the huge contributions aimed at aid to the tune of $4.7 trillion in 2013, politicians, scholars and media are still locked in debates about the positive effect of aid in developing countries (Mahembe et al, 2017).

One camp believe that aid is inefficient and has hurt impoverished nations throughout the years, a different camp hold that the levels of foreign aid is minute to affect poverty diminution in growing nations, but large increment of this foreign aid can impact poverty by decreasing it (Edwards, 2014). Gates and Gates (2014) believe foreign aid is a great investment and does not end in saving people's lives but also create a platform for long lasting economic empowerment.

There are arguments for and against foreign assistance capability to decreasing poverty in growing nations. The first objective of this study is to discern which camp has stronger claims. The second objective is to identify critical success factors that must be in place to enable foreign aids effectiveness in lessening poverty in growing nations. To achieve the first objective, empirical evidences on arguments for and against foreign aids capability to diminishing poverty in developing countries is analysed. The arguments with solid claims are accepted as yardstick for the study. To achieve the second objective, the critical success factors for stronger claims for foreign aids in reducing poverty are assessed to know which one must be in place for foreign aids to be efficient.

The rest of the paper is structured as follows: firstly, a comprehensive review of literatures on foreign aid and poverty reduction in evolving nations are provided, and main debates for and against are highlighted. Critical success factors that are key in viability of aid to reducing poverty and likely aid flow channels are identified. Secondly, the methods for adequate application of aid by beneficiary countries are described, finally, conclusion with summary of findings.

Investigating The Impact Of Foreign Aid On Poverty Reduction Globally

As mentioned in the introduction part of this paper, there is a raving argument among scholars regarding the actual impact the billions of dollars of foreign assistance have had on reducing the global scourge of poverty. In this part, the evidences provided by both sides of the debate are examined critically and a judgment formed positioned on these pieces of evidence on which side has the strongest claim. Additionally, for scenarios where aid has been found to actually lessen poverty, typical critical success factors for such scenarios are identified as these can serve as a viable blueprint for future aid initiatives.

The Positive Effect Of Foreign Aid

The researches that found foreign aid had a positive impact on reducing poverty in evolving nations. (Tawiah et al. 2018; Hussein, 2018; Ardnt et al. 2015; Abouraia, 2014; Birchler and Michealowa, 2016; Riddel and Nino-Zarazua,2015; Gopalan and Rajan, 2016; Ndikumana and Pickbourne, 2016; Oskooee and Oyolola, 2009).

A study by Hussein (2018) was carried out to inspect long-run effect of foreign aid on Jordan’s economic increase. The study employed root unit test and the analysis was applied to 12 different models that incorporated, the different types and sources of foreign assistance. The results showed aid in its aggregated form, has symbolic impact on per capita growth rate during

1970-2014 in Jordan. The co-efficient on aggregate aid stood at 0.59 being positive and significant, indicating that foreign aid in cumulative form add to long-run economic growth.

Another study carried out by Tawiah et al. (2018) for the aim of examining the potency of foreign aid on Ghanaian economy under different political regimes. The study used secondary data for the analysis. Annual time series covering a period from 1980-2016, that is 35 years glean from IMF (International Monetary Fund); OECD (Organisation for Economic Cooperation and Development) and National account data files from World Bank databases were used. The result revealed that with capitalist political philosophy, foreign aid boosts private sector growth through infrastructure development while with socialist philosophy, foreign aid improves human capital through direct social interventions. Foreign aid to Ghana over these 35 years still shows positive effect on the two political philosophies. The result revealed that every dollar amount of aid given under good policy environment, GDP per capita increases by $20.

Ardnt et al. (2015) studied the effect of aid on a range of developmental outcomes such as sources of growth (e.g. physical and human capital), pointers of social welfare (e.g. poverty and infant mortality) and measures of economic transformation (e.g. share of agriculture and industry in value added) in growing nations whereby observational data was employed a detailed regression estimate for effect of aid on average, real growth per capita from (1970-2007) was analysed. Using the measure of aid, AID/GDP as well as (PPP adjusted) real aid per capita, the result showed 1% rise in aid AID/GDP boosted the real GDP growth by 0.3% point.

Similar to other studies on aid and economic growth, Abouraia (2014) studied the effect of foreign aid on economic growth of Philippines to decide whether foreign aid affects Philippines' economic growth positively. The research used data from the World Bank database on the amount of Official Development Assistant (ODA) gotten by Philippines from the period of 2009-2012. To measure this effect, the study used Gross Domestic Product (GDP) as the latest universal ranking by World Bank. The latest GDP rating of the Philippines was at $250,182 million. Also, regression result confirms positive impact of ODA on development such that 1% increase in ODA increases the GDP growth to 0.0035.

Gopalan and Rajan (2016) and Ndikumana and Pickbourne (2016) studied the impact of foreign aid in water supply and sanitation sector. Gopalan and Rajan (2016) analysed the impact of aid expenditures on outcomes in Water Supply and Sanitation (WSS). The study computed a set for 139 countries comprising of middle- and low-income nations from all the region (defined on the bases of World Bank classification) during 2002-2012. The percentage of population that enjoys water supply and sanitation was captured in Organisation for Economic Cooperation and Development (OECD) data on gross foreign aid disbursement to WSS to each nation.

The empirical results show that aid disbursement produce a strong and significant impact on enhanced access to water and sanitation facilities.

Still on aid and its impact on WSS, Ndikumana and Pickbourne (2016) in their study, examined whether targeted aid appropriation to water and sanitation sector can achieve the goal of expanding access to water and sanitation in the Sub-Saharan Africa. A panel set from a sample of 29 countries in Sub-Saharan Africa countries from (1990-2010) was used. Data from OECD/DAC in aid disbursement and aid disbursement from project level from OECD Creditor Reporting System (CRS) database was employed to examine the effect of targeted aid to WSS on both rural and urban populace. Due to the wide gap between rural and urban inequalities, the rural-urban gap is measured by the ratio of population percentage of rural with access to water and sanitation to the percentage of urban population with access to WSS. The econometric result showed that 1% increase in aid to the sector (as percentage of GDP) is associated with between 0.1% and 0.5% increase in the share of rural population that have access to improved sanitation. The authors concluded that increase in foreign aid will have positive impact on access to sanitation in Sub-Saharan Africa (SSA) generally.

Birchler and Michealowa (2016) studied the effect of education aid on primary education enrolment and education quality in evolving nations. They used the most recent data on aid disbursement and econometric specification from aid efficacy research, the evidences suggested that donor increase in funding contributed to a successful increase in enrolment. It showed a complementary relationship between aid for primary and secondary education. The results revealed that aid has been relevant for enhanced enrolment (education quantity) than for increased achievement (education quality) based on the aid disbursement data for education for the past 15 years in developing nations. This was confirmed by Riddel and Nino-Zarazua,(2015) in their study of what has been learnt over decades of aid to education They employed ODA/DAC data from 1995-2010. A total aid to education increased in real terms by 360 percent from USD 2.9bn (income constant 2010 USD). From this period a total aid to primary education increased 630 percent to secondary education by 294 percent and to post-secondary education by 244.268 percent. Whereas the break by subsector of aid to education in 1995 comprised 19 percent to basic education, 10 percent for secondary education and with post graduate attracting 40 percent of the total aid to education. The analysis proved that aid has contributed immensely to education in all aspects.

The study carried out by Mcgillivray (2016), on the impact of aid was to examine the global trends of official aid over the period 1960-2002 on national economic growth per capita in growing nations. A panel data set of some sub-Saharan Africa nations were used. Econometric analysis used revealed that aid appeared to work in the sense that per capita economic development would have been lower in its absence. ODA rose for most year in the 1960s, 1970s, and 1980s. After ODA trends fell downwards from 1990s. It peaked at USD58.3bn in 1991 and dropped to USD43.2bn in 1997. The trends in total ODA is almost totally driven by that in bilateral ODA, the 1990 falls in the former was driven by falls in the later. In contrast, multilateral ODA has been much more stable, trending modestly upwards for the period 1960 to 2002.

Bahmani-Oskooee and Oyolola (2009), carried out a study on poverty reduction and aid: cross-country evidence. The aim of the study was to assess the impact of aid on poverty. The study cited cross-sectional data from 49 growing countries from 1981-2001, unlike other authors that focus on link between aid and economic growth, this study focused on direct link between aid and non-economic variables such as infant mortality. It showed that aid has an effect on infant mortality in aid-recipient nations.

Negative Impact Of Foreign Aid

Unlike studies discussed in the previous sub-section that found empirical support for the assertion that foreign aid assists to lessen global poverty, the studies reviewed in this section found the opposite: foreign aid actually worsen global poverty. (Ferreira and Simoes. 2013; Abdullahi and Amzat, 2011; Moyo and Mafuso, 2017; Elayah, 2016,; Sethi, 2016; Niyonkuru, 2016; Simplice, 2014)

Ferreira and Simoes, (2013), examined the link between aid and economic growth in Africa and Asia. The research employed a sample of 44 Sub-Saharan African countries and a sample of 31 Asian countries from 1972-2007. The total data set was 75 countries within the two regions. Aid was measured as net Official Development Assistance (ODA) relative to GDP. The result indicated a negative link between aid and economic growth in both regions.

Similarly, Moyo and Mafuso (2017) examined the impact of aid on economic growth of Zimbabwe from (1980-2000). The research did not use any participants since it was a content analysis based on research which evaluated relevant information. The record showed aid inflow enjoyed by Zimbabwe government from multilateral institutions (World bank International monetary fund (IMF), African development bank (ADB). IMF $522bn, world bank $1.3trillion and ADB $524bn.Growth in GDP mounted to 11 percent in 1980 and 12% in 1981.The boom ended in 1982 with the economic crisis of Zimbabwe. From 1982 to 1983 the country's balance of payment deficits was over 30 percent. Zimbabwe per capita income was estimated to have fallen by 9 percent over the period of 1990-1996. Zimbabwe received high aid but experienced low growth.

In support of this adverse view of impact of aid in growing countries is the study of Moosa Elayah (2016). The goal of the study was to investigate reasons for the ineffectiveness of foreign aid interventions in developing nations using the examples of Yemen, Egypt and Jordan. It employed two contradictory theories used to explain ineffectiveness of foreign aid. The Public Interest Perspective (PIP) and Public Choice Perspective (PCP). This analysis revealed Yemen received foreign growth commitment and foreign aid equal $18bn. Yemen completely relied on foreign aid. But Yemen's central bank in 2014 recorded internal debt to reach about 300trllion. Egypt's total internal debt reached peak in 2015 to record 99% of GDP, exceeding the barrier of 2 trillion. Jordan got aid totalling 24billion between 1970 and 2007. Total foreign aid constituted the highest proportion of fixed capital in 1975 at around 153% and retreated in 2003 to around 66% of fixed capital. This showed the dependency of Jordan on aid and the weakness in economic policies that work against developing the domestic resource of the country. The list of some best and some worst countries on per capita growth rate was shown as follows: Among the worst were: Nigeria – 1.6%, Niger- 1.7%, Togo – 1.8%. among the best were: South-Korea (5.9%), China (5.6%), Taiwan (4.5%). All these nations have had their fair share of foreign aid or Official Development Assistance for decades.

Sethi (2016) confirmed aid ineffectiveness in his study of aid syndrome and effectiveness. The aim was to investigate efficacy of aid in Pakistan. The review used data from financial year 1973-2007. The analysis of the data used a model to appraise the link between GDP and some key economic indicators. The results showed that 1% increase in aid will decrease GDP by 0.45%, it is significant and negative.

According to Abdullahi and Amzat (2011) on their study of difficulties and challenges of aid in growing countries, their purpose of study was to examine the controversies embedded in foreign aid and to account for the socio-institutional factors responsible for aid failure. They employed the World Bank Report (2012), the data showed a contradiction around shared growth which recognises economic growth as a major driver of poverty. But in reality, in different evolving nations in Africa, the data revealed some of them with economic growth still remain the poorest in the continent. Examples are South-Africa with Gross National Income (GNI) of $304.6 million with a population of 50 million, but GDP per capita growth of 1.5%. Nigeria's GNI at $197.9 million, population of 84 million and GDP per capita growth of 3.3% from 2000-2010 respectively. These scenarios have questioned the positive relationship between foreign aid and poverty reduction.

Niyonkuru (2016), from historical view inspected failure of aid in poor countries. The aim was to examine the nature and importance of aid given to poor nations and to assess the level of impact of other options to development accessible in the continent. The researcher used the case of Ghana where IMF interference hindered economic development of the country greatly. IMF dictate of deferring payment to suppliers of goods and services accumulated the government debts to the tune of 855 million Ghana cedis in 2009 as against 830 Ghana cedis in 2008. This was a negative impact for the government as a result of stringent conditionalities of aid.

(Simplice, 2014), examined if foreign aid had impact on GDP growth, GDP per capita growth and human capital development indicators (literacy rates, unemployment rates and infant mortality rates.) in 22 nations from 1996- 2009. The study revealed some main results, firstly, the impact of aid in economic prosperity (at micro level) increase positively across the distribution and also the positive link between aid and per capita economic growth displays non-linear patterns across distribution, the aid-human development nexus showed negatively across distribution. This could be as a result of mismanagement of aid funds destined for some specific sectors like health and education.

Making Aid Effective Against Poverty: Critical Success Factors

This section assesses the effectiveness of aid in poverty reduction through the lens of critical success factors spotted in some nations that aid impacted positively in the preceding section.

Recommendations are made to mitigate factors that hinder impact of aid in reducing poverty in developing nations.

Today, about 600 million men, women and children are living in abject poverty in growing countries (World Poverty Clock, 2018). Most of the developing countries have been recipients of foreign aid for decades. Foreign aid has the history of being criticized by developing countries as the result of aid being unable to achieve its objectives (Niyonkuru, 2016). But based on the evidences from the review, various countries have reaped the benefits of aid such as improving economic development, growth per capita, human capital development and reduction of poverty.

Countries like Ghana, Zimbabwe, Philippines, Pakistan and Sub-Saharan African countries.

There are some key critical success factors that are pertinent to the effectiveness of foreign aid in poverty reduction. Such factors are: good governance, domestic policies, aid conditionality, donor countries interest and channels of distribution of aid.

Good governance: Good governance has been identified as fertile ground where aid could produce fruits (Niyonkuru, 2016). Influence of political regimes affect the effectiveness of aid greatly. The philosophy of the leader in government can impact foreign aid positively or negatively. Unproductive private government consumption of foreign aid will lead to failure of aid to achieve its purpose. For aid to be successful, donors should encourage receiving countries to increase their savings by cutting down unproductive government consumption of aid and there must be coherence between donors' plan of action and what the countries aspire to achieve as objectives (Abouraia, 2014).

Domestic Policies: Foreign aid thrives well in a condition of good policy environment (Tawiah, et al. 2018). For example, Ghana experiences economic growth when there are sound economic policies to implement foreign aid. Developing policies of poor countries reveal the reason for ineffectiveness of aid programmes. Their policies hinder developmental efforts.

Aid conditionality: Stringent conditionality of aid can hinder the effectiveness of foreign aid (Moyo and Mafuso, 2017). Aid donors are to address some conditionalities to see the fruits of aid in poverty reduction in developing countries. According to Niyonkuru (2016), IMF-related fiscal targets always compel the recipient nations to adopt measures with harmful effects at a long run. The conditionality of aid is acclaimed to ensure effectiveness in resolving problems for which they were to resolve. As a result of this, aid can be withheld, removed or cancelled in times of failure to adhere to the conditionality. Moyo and Mafuso (2017) confirmed that foreign aid is beneficial though its effectiveness is prejudiced by donors' control.

Interest of donor countries: For aid to be effective in achieving its purpose, the donor countries should be neutral toward aid system. But unfortunately, aid is designed to serve the interest of the donor countries. Aid system should be based on the interest of the recipient countries for it to be effective. Too little aid reaches countries that need it most, aid is rather wasted on overpriced good and services from donor countries. It is argued that U.S.A exerts a lot of power in the World Bank and IMF and countries that receive aid from them also receive disproportionate share of the World Bank and IMF loan. They found out that politics has more influence over global aid flow than economic needs. For example, Jordan's aid was reduced as a result of its pro-Iraq stance in the Gulf war. But its re-alignment with the neo-liberal capitalist order, repositioned it in the global economic order thereby attracted a write-off of U.S. debt of about $900 million and an increase in foreign aid. Jordan became the fourth largest recipient of U.S. assistance.

Channels of distribution of aid: There are several channels by which aid affect poverty in the developing nations. The two major channels are: The traditional growth channel, which believes foreign aid will stimulate growth through increasing investment and the growth would lead to poverty reduction. Based on the evidences from the review, it is inconclusive if such growth translates to poverty reduction. The pro poor public expenditure channel .This channel compose of expenditure which are likely to benefit the poor. This includes government expenditure on social sector like, healthcare, primary education, and water and sanitation (Gopalan and Rajan, 2016).

United Nations (2013), opined that for securing sustainable human development, reducing poverty and achieving other developmental goals, access to social services such as education, healthcare and portable water are prerequisites.

Conclusion

Developing countries have over the years been relying on foreign aid for economic growth and poverty reduction. But many of them particularly the Sub-Saharan African nations are still wallowing in abject poverty. Therefore, they criticized aid as being ineffective in poverty reduction. The evidences from the review has revealed pertinent critical success factors such as, good governance, domestic policy, aid conditionality and donor countries' interest to be adopted for aid to be effective in reducing poverty as mentioned in the discussion section of this paper.

These critical success factors should serve as a blueprint for developing countries including Nigeria to adopt for aid to be effective for economic growth and poverty reduction. Further studies can explore more critical success factors that can make foreign aid effective in poverty reduction in developing countries.

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