Abstract

Development Assistance or commonly termed as Foreign Aid began more than fifty years ago in order to fuel economic growth in the developing world. There is no question that aid had some outstanding successes to validate over the years, such as the eradication of some life threatening diseases and the increase of life expectancy. According to the estimates, in 1970, there were approximately 2.2 billion people living in extreme poverty and there were 705 million people living in extreme poverty in 2015. The number of extreme poor people in the world is 3 times lower than in 1970. Despite the billions of dollars spent each year on growth activities, almost three billion people live with less than $2.50 per day. Scholars and Economists have been trying for years to establish, whether a link between aid and growth can be recognized, but despite the substantial volume of work, no consensus has been reached. In this context, proponents of aid argue in favor of an increase of aid disbursements to poor countries so as to support plans at global while critics underline the negative aspects of aid and ask for major reforms. The paper is a snapshot of various propositions in debate over the issue with its current status analysis and suggestions.

I. INTRODUCTION

The essence of financial aid can be seen post-Bretton Woods (1950s). The success of Marshall Plan, on the other hand, gave a lot of comfort and confidence to the international policy makers that aid would be a good idea from the capable to the needy ones. This was the era of two gap model suggesting that if money is put into any economy, it increases investment leading to growth and reducing poverty. This ideology
popularized the aid concept as it was opined to be impactful enough to boost growth and reduce poverty. The model posits that evolving economies confronts with gaps which they have to fill. The major gap is between investments and savings in the economy. Any developing nation suffers from the debacle of very low saving rate on one side, but it has to participate in a big push by investing heavily in infrastructure and other services on the other side. So, what ways countries could fill the gap? A lot of debate among economists moves around the subject. Some argued that emerging economies need aid from developed nations. The others maintained that the aid has been ineffective in pumping up the growth process and poverty reduction. It has only aided a few deprived to a minimal extent and facilitated the donors in their motives of remaining powerful and exercising control. A number of papers over the years have argued that we should not overplay what aid can do. The biggest critiques from the fields of finance and economics have compiled the issues affecting aid in common-Corruption, Inflation, Debt Burden and Dutch disease to name a few. Some have also highlighted that aid erodes the sanctity of a democratic contract and severs the link between an individual and the government. The African continent has shown many signs of economists disapproving aid. Moyo (2010) mentioned that on an average 70 percent of the government revenues in Sub-Saharan Africa is financed by aid flows. So, the government’s entire focus is on the donors and do not really feel accountable to the people on the ground. Huge aid flows have done little to change the development trajectories in Africa, in the meantime, more than a quarter of the countries in Sub-Saharan Africa are poorer now than in 1960 reflecting no sign that the aid given, however substantive, will eradicate poverty there. The another school of thought that has evolved during the debates was that aid is ineffective as it is quite expensive and so should be put on a chopping block. They believed that money granted to others would serve much better in their own countries. The counters came stating that aid represents a tiny portion of a government’s budget. Even when the economic situation of the donor nations is dire, they can still afford to maintain the commitments. Many propose that the small amount of money which goes into the budget towards International Development Assistance puts a remarkable impact on the lives of the millions of poor people across the world. For them it is a matter to be viewed in the optimistic lights. One of the best examples supporting the aid is GAVI, set up in year 2000 with a view of bringing public and private sectors on a common platform for providing equal access to vaccines for children, wherever they live. By 2015, it reached 500 million children in poor countries and prevented more than 7 million deaths in the process. It aims to ramp up the number to additional 300 million children by 2020, preventing further 5-6 million deaths.

II. KEY TERMS

i.) **Bretton woods:** The United Nations Monetary and Financial Conference was organized from July1-22, 1944 post World War- II in Bretton Woods, New Hampshire. The delegates from forty-four countries formed a new international financial
arrangement known as the Bretton Woods system, envisioning exchange rate stability; prevent competitive devaluations, and stimulation of economic development for all. It drafted up a plan for the International Bank for Reconstruction and Development (IBRD) for making long-term capital available to nations in need on urgent basis such foreign aid. Another project worked upon was establishment of International Monetary Fund (IMF) in order to stabilize exchange rates by funding short-term disparities in international payments system.

ii.) **Marshal Plan:** The Marshall Plan or the European Recovery Program, routed billions of funds for the economic recovery of Europe between 1948 and 1951. It was successful in igniting the phase of economic recovery by meeting its objective. The plan was to refurbish the confidence of the people in Europe and the economic future of Europe as a whole. The program is named after Secretary of State George C. Marshall, who announced it on June 5, 1947. Fifteen nations, together with Germany, joined the program and designed the assistance they required, with administrative and technical assistance from United States. European countries were granted nearly $13 billion in aid, which primarily resulted in staples, fuel, shipments of food and machinery from the United States of America. Later resulted in investment in industrial capacity in Europe. Marshall Plan funding ended in 1951.

iii.) **The Theory of Big Push:** The big push model is a concept in development economics or welfare economics that emphasizes that a firm's decision whether to industrialize or not depends on its expectation of what other firms will do.

iv.) **Dutch Disease:** It is the negative or the adverse effect on an economy of anything that leads to a sharp entry of foreign currency. The term was coined in 1977 by economists, to describe the miseries of the Dutch economy.

v.) **Two Gap Theory:** The two-gap model is an extension of the Harrod- Domar growth model, implies that investment and growth are constrained by either domestic saving level or capacity of import purchase.

vi.) **Official Development Assistance:** Official development assistance (ODA) is defined as government aid designed to promote the economic development and welfare of developing countries. Loans and credits for military purposes are excluded. Aid may be provided bilaterally, from donor to recipient, or channeled through a multilateral development agency such as the United Nations or the World Bank. Aid includes grants, "soft" loans (where the grant element is at least 25% of the total) and the provision of technical assistance.

### III. LITERATURE REVIEW

There was an active argument from economic and political realms for helping poor countries. Mid of 20th century was an age when economists widely thought that pushing money into factories, roads and other infrastructure in an already well-off economy or one wanting to get richer is vital for triggering growth. So in the expectations of...
spreading market-based economies and Liberal democracy and, the Western European powers and United States stimulated foreign aid to poorer countries.

- Sam, Allen and Adrian (2005) proposed certain guiding principles for making the foreign aid work for each country.

Experience suggests five key principles for making the country-led approach work.
1. The donor nations should plan their funding not on the basis what they think is good for the receiving nation but should align the finances as per the plans, budgets and needs of the receiving country. They should not try to tell what others should do with the grants but should work on what others want to achieve from the aid.
2. Donors must pay attention to partner countries’ primacies for aid delivery, which vary widely from country to country. The foremost need is for a flowing long-term anticipated finance to spend as per their financial plan, including to meet the recurring costs of access to services. To make the grade for this type of aid, countries also need do develop strong, believable and consistent administrative, financial and technical systems.
3. A harmonized attempt should be to avoid multiple donor policies and distribution mechanisms, which wastes the limited capabilities of partners. In countries which are aid-dependent with many donors, the achievements from harmonization may be reaped well, but countries with fewer donors working in unrelated sectors, the government may prefer to deal with donors separately. Harmonization is not an end in itself, but a means to improve the alignment of aid with government priorities and systems.
4. The aid flows should be made more predictable as it is risky for the recipients to make long-term expenditure commitments for example employing more teachers or opening new industries. The donors, so far, have set their own multiyear projects to run in recipient nations, but have commonly provided budget provision to governments only on an annual, or sometimes on three-year, basis. The donors’ accountability to their taxpayers and assemblies makes it tough to assure funding far into the future, irrespective of circumstances.
5. Just as emerging economies need to be answerable to their own people and to their donors for how aid is used by them, in turn the donors should also be held liable to the recipients for how and when the aid is given.

- Deaton (2009), a Nobel Prize winner studied poverty in India and South Africa shared his ideas about foreign aid being challenging and provocative. Deaton debates that, by helping poor population in rising economies, the developed world may in fact be corrupting them, governments and decelerating their growth. In his paper he focused on the macro and micro issues surrounding foreign aid. His work found that whether and how the aid works. He talked about the frustration that World Bank and other aid providing agencies have, for not being able to read methodically from its projects about what works and what does not. He argues that when a government miscarries its necessary duties which only government
can do then an economy cannot develop and the average population will remain miserably poor.

- Hansen and Tarp (2000) in their empirical analyses of 30 years using cross-country regressions in assessing the effectiveness of foreign aid found that a consistent pattern emerges: (i) aid increases cumulative savings, although not proportionate to aid flow (ii) aid upsurges investment, and (iii) whenever progress is driven by capital accumulation, aid has a positive influence on the growth rate. Hansen and Tarp (2001) scanned the connection between foreign aid and growth in real GDP per capita and found that aid in all prospect, increases the growth rate, and this result is not restrictive on ‘good’ policy. However, there are, decreasing returns to aid, and the assessed effectiveness of development assistance is highly sensitive to the set of control variables and choice of the estimator. No progressive effect of aid is found, when investment and human capital are controlled for. Yet, aid continues to impact development and growth via investment. They concluded by emphasizing the need for more theoretical work, before usage of cross-country regressions for policy purposes. Empirical conclusions based on cross-country growth regressions about aid effectiveness depend on poorly understood non-linearities along with critical methodological selections.

- Radelet (2006) had an opinion that the main problem facing aid agencies is the indirect and detached relationship between the people actually providing the financing i.e. the taxpayers in donor countries and the poor people in low-income countries. The principal-agent relationships have a long and complex chain. The taxpayers who elect officials, who become principals and delegate authority to the heads of aid agencies who in turn delegate to their employees, contractors, and consultants. On the other hand, there are parallel relationships among residents, their government, and those actually implementing the programs on the ground, in the recipient country. There is always a mismatch in the objectives, information and incentives of these agents and the objectives of either the taxpayers of donor nations or the beneficiaries of receiving nations. He quotes that all the debates raging for decades about whether particular IMF and World Bank conditions are justified and question arises such aid supporting or hurting the economic equilibrium, growth, and development. The question arises, if donor-imposed conditions make situations worse, who shall bear the cost? Secondly, while donors are condemned for commanding too many conditions, they are equally criticized for not imposing enough conditions. The World Bank is asked very often, to impose conditions to force governments to take specific actions, like projects that are adverse to environment. Most experts nod to the matter that governments device reforms only when it is in their interests. There are many who continue to give out aid even when recipients flop to meet conditions. He found that an attempt to solve the principal-agent issue through conditionality has not
been successful. Though new set of reforms aimed at solving such problems seem to be effective but the systematic evidence is yet to be presented to the world.

- Harry, Stephen and Paul (2016) say that people approve of bilateral foreign aid to the poor countries for improving the wellbeing of the people living there. But question, on how to judge if it is important to citizens whose taxes actually fund the aid? The investigated the question using a discrete choice experiment. Effectiveness aid is important to people when choosing countries to be supported with bilateral foreign aid. Both criteria are more important than others. The least important attribute is strategic links between the donor and recipient countries. Overall, they found in their study that people like aid to be targeted where it is most likely to improve the wellbeing of the people, but do not really appreciate if the aid is not going where suffering is the greatest.

- Raghuram and Arvind (2006) ask why it is hard to find a robust impact of financial assistance on the long-term growth of poor countries, even those working with good policies. “We look for a possible offset to the beneficial effects of aid, using a methodology that exploits both cross-country and within-country variation. We find that aid inflows have systematic adverse effects on a country’s competitiveness, as reflected in the lower relative growth rate of labor intensive and exporting industries, as well as a lower growth rate of the manufacturing sector as a whole. We provide evidence suggesting that the channel for these effects is the real exchange rate overvaluation caused by aid inflows. By contrast, private-to private flows like remittances do not seem to create these adverse effects, a finding for which we offer an explanation”.

- Ann and Per-Ake in a found that efficiency scores in labor and energy intensive countries display lower relation to less labor and energy intensive countries and found indications of a positive relationship between capital intensity and country efficiency. However, their findings based on data for the period between 1995 and 2000 are inconclusive in finding the relation between aid and efficiency as there is no clear pattern to be found. The study covered the performance of 60 countries evaluating aid effectiveness in a production theory framework, using the Data Envelopment Analysis (DEA) method. This approach considered all factors of production, and so also included the energy and capital components of production, implying that evaluation of economic performance can be considered in terms of achieved production in relation to all resources used in the process.

IV. SCOPE AND OBJECTIVE

Though the literature on the effectiveness of foreign aid to the nations is caught up in controversies, with assertions and explanations about its usefulness, this paper takes a view of what the world’s leading agencies have to say on the subject matter. This report is based upon a review of the recent studies majorly, but is not completely time bound due to the preponderance of debate it has spurred since its inception as development
The foreign aid dilemmas

assistance has always overlapped with issues and needs of the emerging economies and the motives of the powerful ones. The aim of this paper is to review aid effectiveness in terms of different methodologies used in its analysis, investigating various factors that hinder aid effectiveness, donor commitments and development assistance status of the world. Concluding remarks have also been incorporated along with suggestions on the subject matter.

V. RESEARCH METHODOLOGY

Statistical techniques like tables, graphs and charts have been used in order to analyze the information collected, and present the study in a systematic manner.

Source of Data

The study is entirely based on secondary sources. The information has been collected majorly from “The Organization for Economic Co-operation and Development (OECD)”.

VI. ANALYSIS AND DISCUSSION

- Development aid totalled USD 131.6 billion in 2015, representing a rise of 6.9% from 2014 in real terms as aid spent on refugees in host countries more than doubled in real terms to USD 12 billion. Stripping out funds spent on refugees, aid was still up 1.7% in real terms, according to official data collected by the OECD Development Assistance Committee (DAC).

- Official development assistance (ODA) from the 28 countries in the DAC averaged 0.30% of gross national income, the same level as in 2014. Measured in real terms – correcting for inflation and for a sharp depreciation in many DAC country currencies against the dollar last year – ODA is up 83% since 2000, when the Millennium Development Goals were agreed.

- The 2015 data show that bilateral aid to the poorest countries rose by 4% in real terms, in line with commitments by DAC donors to reverse recent declines. Bilateral aid, making up around two-thirds of ODA, is aid provided by one country to another country. The 2015 data shows ODA rose in 22 countries, with the biggest increases in Greece, Sweden and Germany. Six countries reported lower ODA, with the steepest declines in Portugal and Australia. Of the several non-DAC members who report their aid flows to the OECD body, the United Arab Emirates posted the highest ODA/GNI ratio in 2015 at 1.09%.

- Only six of the 28 DAC countries - Denmark, Luxembourg, The Netherlands, Norway, Sweden and the United Kingdom – met a United Nations target to keep ODA at or above 0.7% of GNI. (OECD 2016)
Figure 1: Bilateral ODA Commitments by Purpose

Figure 2: Social Infrastructure & services

Figure 3: Economic Infrastructure & services
Analysis of Data extracted from OECD.stat

As the figure suggests aid to social and infrastructure sector has gained the highest proportion (385513.5 million USD) of the total aid commitments (762234.7 USD). Education and water supply sanitation are the two core focus areas in the sector as per DAC. Aid to health has increased over the years, particularly with the AIDS crisis and the emphasis in the Millennium Development Goals on dropping the incidence of preventable disease as well as maternal-child mortality. Total Aid commitment to production sectors (67407.98 million USD) and economic infrastructure over the years (166559.6 million USD), has fallen, largely as a result of disciplines on tied aid imposed by the DAC in the early 1990s. Program assistance aid tends to fluctuate year to year with a total of 35251 million USD of commitment till 2015. Over the long term, two major components of non-sector aid have been debt relief and humanitarian aid, which usually account for 5-10% each of total aid.

The net total aid as reported by DAC shows a slight dip of $6006 million percent from 2014 to 2015. The net aid has touched an amount of $131,433.4 million by 2015.
aggregation included the rise in bilateral aid from 69 percent to 72 percent. The world enjoyed rapid economic growth from 1960 to 1973 and so the aid to economically effective countries such as Brazil, Chile and Turkey went down. Total grants remained stable in real terms but floored as a share of donors’ rising national incomes. From 1974 to the end of the Cold War, aid rose in real terms. Many donors attained the UN ODA target of 0.7% of national income. Year 2005-06, exceptional debt assistance to Iraq and Nigeria triggered a motion in aid volumes.

![Figure 4: ODA receipts Per Capita](https://www.oecd.org/dac/stats/documentupload/MeasuringAid50yearsDACStats.pdf)

The poverty emphasis of aid has been refined over the years. Assistance per capita received by the least developed countries (LDCs) went up rapidly after this group was officially established in 1971. It fell noticeably in the 1990s, however, as aid budgets compacted and “Donor fatigue” spread, especially in response to perceived poor consequences in Africa. In the last decade, higher aid levels have returned. Aid to less disadvantaged developing nations has always been lesser than aid to LDCs and, on the whole, since 1970, it has dropped bit by bit nearly up to 40% in real terms. India has been the second largest recipient after Afghanistan in terms of gross official development assistance received by the year 2015. The top donors have been- World Bank, Japan, Germany, Asian Development Bank, United Kingdom, Global Fund (to fight AIDS, tuberculosis and malaria), USA and European Union, France. In 2009 Africa was the largest receiver of ODA, at $28 billion of which $25 billion was directed to countries south of the Sahara, with Sudan getting approximately $1.9 billion and Ethiopia receiving $1.8 billion. Asia was paid the second largest amount at nearly $24 billion.

**VII. CONCLUSION**

The United Nations, NGOs, Donors and other International agencies lend for building infrastructure and creating services in the needy nations, which sounds very impressive in the meaning and value it holds. The question arises that how much money is actually spent in countries, it is meant to help. The answer is not much. Generally, goods needed to carry on and sustain operations are imported from other countries. Now, for countries
to be free of international dependence not only they need schools, hospitals, roads and industries etc., but also a functioning economy that can create jobs and supply goods and services, its citizens demand. While billions of dollars are spent on aid and peace keeping each year, most profits and proceeds are sent back to the development world leaving a little sustainable investment behind. This creates a cycle of dependence on foreign resources. In an economy where people remain unemployed, economic growth is slowed and instability creeps in.

So, where should we head for the solution? Instead of shipping goods and services from other countries to carry on projects, the international community could start buying local. This would allow critical services to be provided while creating much needed livelihoods and developing a local capacity. The Make in India campaign is an example supporting the solution. Why it is not happening already, because of obstacles to local procurement including corruption, absence of information and convoluting contracting process, all of which inhibits the local sourcing process. An innovative approach is needed to provide a set of services like training, ender distribution, market research, match making of the buyer and supplier etc. This will help facilitate connections between the international community and local companies. The domestic firms, then, could be used wherever possible to carry out business. By spending locally businesses can earn the courage to grow and industries evolve. National governments can invest new tax revenues to build infrastructure and simultaneously corruption is reduced as businesses enter the formal economy.

The world is changing, so is the landscape in which the development assistance and respective policies operate. The economy of the world has evolved many folds in last decade. Developing and emerging economies are driving the economic growth. Year on year new sources of development finance are mushrooming making new actors and instruments entering the development scene. The growth rate of China and other parts of Asia has led to a massive drop in the poverty rates. The World Bank gauged that the number of poor people in the world fell by about 700 million between 1981 and 2010, and in China during the same era, the poor population fell by 627 million. The notion that huge donations can remove or at least reduce poverty to a great extent has controlled the principle of economic development since the 1950s. Over the past six decades, millions of people have evolved out of miserable poverty around the world, but that had slightly to do with foreign aid.

Never in our history has the wealth expanded so quickly. Digitalization is increasing at a rapid rate providing new and exciting opportunities to create and engage change. However, our future and the way ahead is still full of challenges. A nine billion of population is projected on earth by 2050. The biggest challenge ahead of us would be to improve the lives of poor in fragile low income states. The aid is being questioned more and more. In order to keep up the process of being generous and also increasing the aid budget, the aid has to show itself to be relevant. It needs to relate to global trends and new technologies. It needs to improve the lives of the poor and oppressed. It needs to
align itself with other flows around the globe in a way it is not doing so at the moment. Right organized development aid can accelerate the sustainable economic growth and improve the living conditions of the poor, especially in the countries which lack the capacity or the will to do so. The aid can resolve the issues of common goods, trade, good governance, financial stability, peace and security. We need to look at aid with new eyes and a dynamic approach to focus on individuals, where entrepreneurs and human rights activists act as drivers of change, where innovators offer new and promising solutions to our problems.

VIII. REFERENCES