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## ADDRESSING THE DICHOTOMY OF FOREIGN AID

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### ABSTRACT

Does foreign aid really work? Many inhibited questions raise such a vociferous debate. The standard definition by the 20OECD- DAC explains "Foreign aid (or the equivalent term, foreign assistance) as financial flows, technical assistance, and commodities that are designed to promote economic development and welfare as their main objective (thus excluding aid for military or other non-development purposes); and are provided as either grants or subsidized loans." When a large scale conflict or disaster happens in the world, governments and other donors come together and commit extraordinary resources to address the crises in the affected country. This paper addresses the dichotomy of conditions which determines the effectiveness of foreign aid. These foreign aid programs, primarily aim to address poverty alleviation, promotion of development, growth and self- sufficiency, as their long term goal. But, have these programs in their humanitarian attempt to do so, been successful enough? The success of aid depends on the supporting infrastructure, policies, governance and implementation of the process set in place by both, the donor and the recipient countries. It explores the multiple objectives of aid and the relationship between aid and growth. Presenting the case study of Bangladesh, analysis on the effectiveness of foreign aid along with its conditionality is discussed.

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### INTRODUCTION

Let us dig deeper into the debate and have a look at the dichotomy being pointed out in this paper. What stands as the biggest obstacle to achieve in many of these Aid goals is public apathy. The way the citizens react and understand aid. Foreign aid aims to promote economic and human development. Citing Foreign Aid as "*an unprecedented economic experiment*", Peter Boone in his paper, introduces us to this topic with a critical viewpoint. He discusses how historically, foreign aid programs had been launched long before the emergence of compelling theories or evidence that proved their efficiency or answered the question of whether they could work. (P. Boone, 1995) Supporting his theory, this paper aims to discuss the multiple motivations and contradictory objectives of aid.

*"The notion that aid can alleviate systemic poverty, and has done so, is a myth. Millions in Africa are poorer today because of aid; misery and poverty have not ended but have increased.*

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*Aid has been, and continues to be, an unmitigated political, economic, and humanitarian disaster for most parts of the developing world."*(D. Moyo, 2009)

African economist and author, Dambisa Moyo discuss the so-called glamorade of aid in her stinging critique, "Dead Aid", arguing that aid is not a solution, rather a problem in context to Africa and its development. She talks about elected governments to be made accountable to the domestic citizenry and not to donors, bringing forth an underlying subject of public apathy. "*No society would appreciate their whole policy and their future of their children to be depended on donors who don't actually live in the country.*"(D. Moyo, 2009)

Another contemporary standpoint in the favour of this argument is offered by the Bill and Melinda Gates Foundation who launched their organization in 1997 focusing on innovative and economic solutions to foster growth and development. In recent years, they have been very vocal about the distorted picture that is portrayed to the world about the countries that get aid.

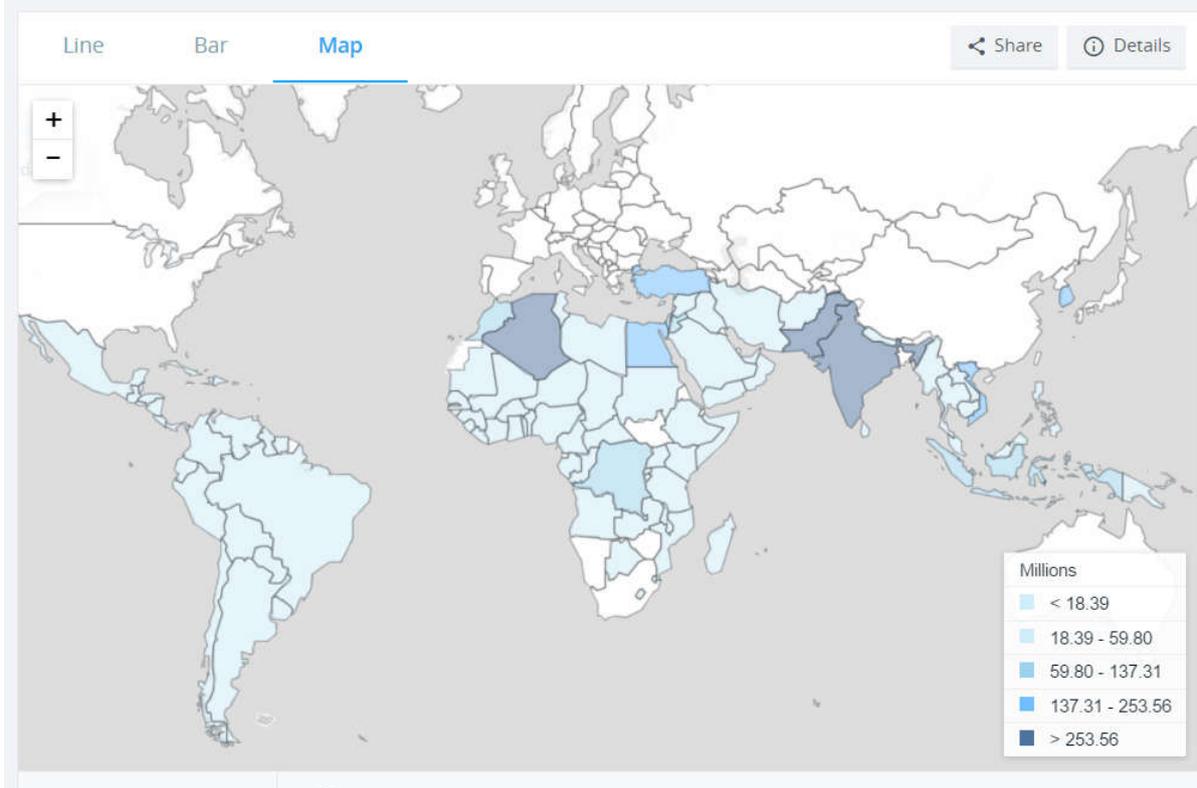
"I worry about the myth that aid doesn't work. It gives political leaders an excuse to try to cut back on it—and that would mean fewer lives are saved, and more time before countries can become self-sufficient...broadly speaking, aid is a fantastic investment, and we should be doing more. It saves and improves lives very effectively, laying the groundwork for long-term economic progress." (Bill and Melinda Gates, Annual letter 2014)

## Types of aid and assistance

To understand the dimensionality of Aid disbursements and derive workable solutions, we need to first understand the types of aid and the context in which they are referred to. Foreign aid is given with such different purposes in mind that though precisely measured, the sheer diversity of disbursements makes identification of effects almost impossible.

Development Assistance Committee of the Organisation for Economic Co-operation and Development, Geographical Distribution of Financial Flows to Developing Countries, Development Co-operation Report, and International Development Statistics database. Data are available online at: [oecd.org/dac/stats/idsonline](http://oecd.org/dac/stats/idsonline).

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## The controversy of the donor's objectives

"The challenge of aid is not isolated to the (Millennium Development goals) MDGs. Donors expect aid to help achieve many other objectives, including the promotion of international peace and security." (M. McGillivray, 2005) Many developmental objectives which, the practice of foreign aid targets, are based on the fundamental assumption that aid works in alleviating poverty. Yet its effectiveness in achieving these objectives and other developmental outcomes has been questioned for decades. While the intentions from the very beginning were that foreign aid would finance productive investments in order to help developing countries achieve 'take-off', the first studies to assess the returns to aid yielded mixed result. Another theory suggests that aid is now thought to have a positive impact and that donors are paying more attention to the developmental criteria in the application of Aid framework by employing better empirical methods and gaining access to details analysis to its impacts. (McGillivray, 2003a, 2002b). When the economy is weak, the people who suffer the most are the poorest. "There is evidence that Aid's impact on growth is contingent on the policies of recipient countries, so that while aid works in all countries it works better in countries with better policy regimes" (Radelet, 2008).

The DAC classifies aid assistance into three broad categories;

1. Official development assistance (ODA),
2. official assistance (OA)
3. Private voluntary assistance.

While the ODA is the largest form, consisting aid provided by donor governments to low-middle income countries, OA is the aid provided by governments to richer countries with per capita income higher than \$9,000 approx. and to countries that were officially a part of the Soviet Union and its satellites. Examples of such recipients could be Bahamas, Cyprus, Israel Singapore, etc. Private voluntary assistance includes funds and grants by NGO, charities, foundations, private companies, etc. These funds are channelled through what is commonly referred to as multilateral and bilateral aid. This framework is briefly explained in Fig.1.

The OECD distinguishes these two channels as follows:

"Bilateral aid represents flows from official (government) sources directly to official sources in the recipient country. Multilateral aid represents core contributions from official

(government) sources to multilateral agencies where it is then used to fund the multilateral agencies' own programmes."

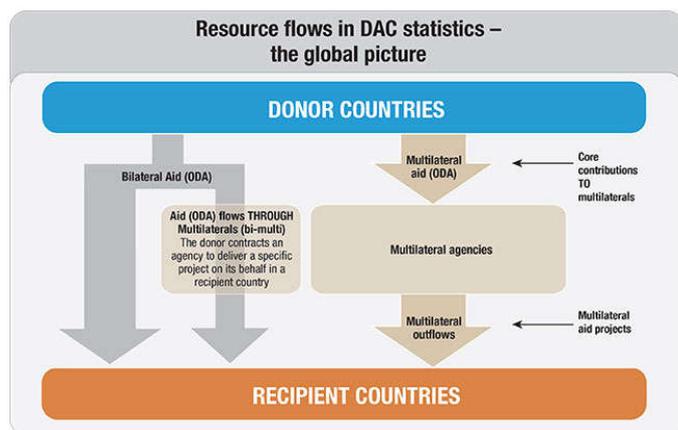


Figure 1. Source: <http://www.oecd.org/dac/stats/faq.htm>

In some cases, a donor can contract with a multilateral agency to deliver a programme or project on its behalf in a recipient country. Such cases are typically counted as bilateral flows and are often referred to as Bi/Multi." (Oecd.org, 2018). Another doubt that develops after explaining this distinction is about the difference between multilateral agencies and the aid received through (Non-Profit organizations) NGO's or private organization. The simplest distinction is the governance of the organizations. Multilateral agencies such as the <sup>3</sup>UNDP are governed by the representatives of the governments while NGO's and private organizations do not have direct government representatives involved in their governance. They generally have representatives acting in their private capacity.

"Historically most aid has been given as bilateral assistance directly from one country to another. Donors also provide aid indirectly as multilateral assistance, which pools resources together from many donors." (Radelet, 2006)

Multilateral institutions like the World Bank, International Monetary Fund and various UN agencies include over 210 major organisations and funds as well as numerous smaller trust funds. (OECD. 2011). "The professionalization of the development industry has made the ratio of bilateral to multilateral assistance now a matter of greater comparative interest. Approaches to aid allocation are being looked at more closely to assess their desirability and potential for replicability" (Gulrajani, 2016)

The conditionality of foreign aid, the dependency it creates in the recipient countries and assessing the immediate vs. the long term effects of foreign aid has always been subjected to global controversies. Todd Moss et al., (2010) suggests that "institutional development is an independent variable which affects the productivity of aid and is a recognized factor used to select and allocate to aid recipients". (Ojeaga, Paul & Ogundipe, Adeyemi & Ogundipe, Oluwatomisin, 2014)

From the recent examinations, a large amount of empirical data suggested that "foreign aid exhibits a zero effect on growth or any other indicators of poverty, supporting the public choice theory." (Ovaska, Tomi, 2003). However, Svensson (1999) and Burnside and Dollar (2000) discuss the effectiveness of aid in terms of growth when combined with the "the right conditions, specifically the right policy and

institutional environments." Supporting this argument, Leeson (2008), offers an alternative explanation which suggests that most developing countries with weak institutions and bad policies, contribute to their poor economies. Thus, where aid is needed, it will be unhelpful because the necessary supporting institutions are lacking. Areas where aid does or can do some good, in countries with good or effective policies and institutions in place, it is not needed. And the dichotomy stands in these two statements. To gain a clear insight into these contradicting statements, a formal and detailed assessment of the region-specific case studies is very imported. We wouldn't be focusing on the case of Africa of any Sub-Saharan countries in this paper as enough as these regions have been over-evaluated, prejudicially assessed and criticized over the last few decades. The case study of Bangladesh offers a fresh perspective and is less dicey, so to say. It also showcases the gaps and inefficiencies as well as the progress stories over the last 40 years of its independent existence.

### A case study of Bangladesh

In the last four decades, Bangladesh has achieved notable economic and social progress in the development context. Following a bloody war, when it became independent in 1971, there were many concerns about the country's economic viability. Predictions of Aid dependency and its long term effects were controversially discussed, while a few critiques referred the country as a "test case of development" (Faaland and Parkinson, 1976). They suggested that if a country with such colossal and profuse development problems could make development happen, then perhaps any other country could. Despite this widespread of pessimism, Bangladesh has made significant economic and social progress in the last 4 decades. The Diagram below shows us the evident comparison of Aid received compared to the overall growth in terms of <sup>4</sup>GDP in the country.

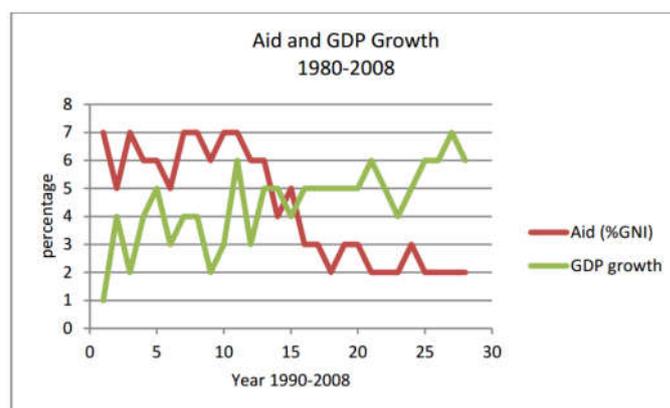
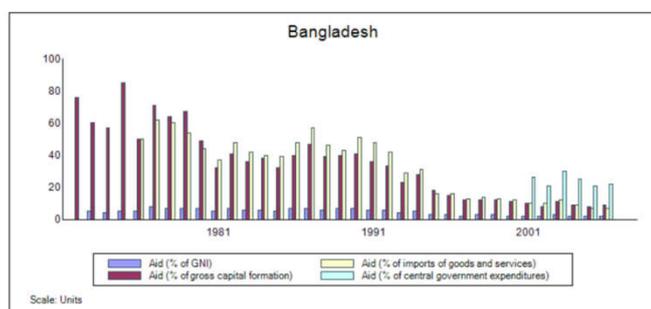


Figure 2. Net official development assistance to Bangladesh (% OF GDP) and gdp growth Source: data from WDI (2009)

Bangladesh has received a huge amount of foreign assistance over the last 3 decades. It received \$48 billion of foreign aid with an annual flow that has ranged from \$1.0 billion to \$1.5Billion approx. from 1971 to 2008. The composition and the aid patterns did evolve over the years. Commodity aid was A significant factor in the early post-liberation period. However, in recent years, this has seen a decline almost close to zero as the country has become more self- sufficient. The policy-making/lending, as a general trend in following the international development guidelines, both at a macroeconomic and sectoral level has become significant and

is established as a part of the assistance program. This development has been accompanied by increasing focus economic and sector work, the formally known knowledge products, by multilateral institutions. The world bank has been the largest as well as the most influential lender to the country. It has also been the coordinator of aid donors in Bangladesh. The initial phase of development in terms of the effectiveness of aid yielded mixed results. The evaluation reports of world bank went as far as to argue that “a core constraint in the development process in Bangladesh was the government itself and its unwillingness to enforce the needed public sector reforms” (World Bank 1998b, p. 56). To address these issues, the World Bank imposed more stringent policy conditions and made several structural adjustments in its assistance program. Governance became the principal emphasis of its program. While the Asian development bank was the second largest lender, Japan has been the largest bilateral donor to Bangladesh.



Source: Data from world development Indicators (2009)

**Figure 5. Foreign AID as a percentage of government expenditures, per capita income, imports and investment**

*"In the 1970s, soon after independence, external resources financed more than 70 per cent of the country's investment, but this had fallen to less than 10 per cent in 2005 (World Bank 2007b). This reflects, on the one hand, the government's relative success in mobilizing domestic resources and on the other, the increasing vigour of the private sector."* (M.G.Quibria, 2010).

Nevertheless, it is still in its rudimentary stage of economic and social transformation and as Sachs (2005, p. 14) correctly noted, Bangladesh has barely managed *"to place its foot on the first rung of the ladder of development."* As the percentage of GDP showcased a steady growth, Bangladesh has received lesser foreign aid. The importance of aid as a source of investment has reduced over the years. The Center for Policy Dialogue, a premier think-tank of Bangladesh, in its policy seminar on aid effectiveness (organised in 2006) had the following sampling of views expressed by its participants:

- *The donors have a disproportionate influence on policies.*
- *Conditionality is limiting the policy autonomy of the government.*
- *The disjunction between the benefits of adjustment loans and the costs of adjustment acts as a disincentive to implement reforms.*
- *The reforms should be home-grown and vetted by parliament.*
- *Donors have had little impact on poverty reduction in the country.*
- *There should be more aid to higher education.*

- *The PRSP is a poor substitute for planning*
- *Reforms are not owned because they are imposed*
- *Donor policies are inappropriate*
- *The Washington-consensus has yielded few benefits for Bangladesh (Cpd-bangladesh.org, 2005)*

In spite of the fine results in the economy, the foregoing comments suggest that aid has been less than effective also has had a little direct impact on poverty reduction. Inadequate flow of aid could not help significantly in the growth process of an economy however, a large inflow of aid may also lead to economic pathologies such as the Dutch disease, i.e., the flow of aid causing an appreciation of real exchange rate and thereby impede the expansion of exports and growth of income. In the case of Bangladesh, there is very little or no evidence to suggest that foreign aid led to serious overvaluation of the real exchange rate and erosion of export competitiveness. Compared to neighbouring countries indeed, Bangladesh's real exchange rate has become increasingly competitive over time. Thus the apprehension that aid may cause <sup>5</sup>Dutch disease and overvaluation of the real exchange rate is unwarranted.

## Conclusion

Aid as a practice could be ineffective for many reasons. It can be ineffective if it is inadequate or too much in quantity in relation to the country's need. If it is too small and erratic, it might not have any significant impact on the country's economy, growth and development. It is too large, it can lead to various social and economic problems and raise different forms of dependency. In a few cases, it can hit the country's absorptive-capacity constraint which could in return lead to delays and inefficiencies in aid utilization. Similarly, just on those lines, easy availability of aid can obviate the incentive for undertaking genuine reforms and the necessity of making hard decisions. It thereby perpetuates bad policies, poor governance and endemic corruptions. Poor policies can also emerge from donor's initiatives and conditionality. They can be out of synch with the requirements and one-size-fits-all policy impositions at times thwart the economic development of the county.

The market or the private actors should be allowed to coordinate the activities that promote economic success and bottom's up approach historically has worked, however, it may be more beneficial to the development process if the large scale, top-down government-supported agencies transform their outlook towards aid only in the monetary terms and start focussing on the multidimensional features of International foreign aid. This does not leave us with an impression that aid alone is the answer. Countries ultimately have to be able to sustain funding for issues like agriculture, health and ultimately wean themselves out of aid. We know though that aid can play a helpful role in putting countries on the path to independence by breaking the vicious cycle of poverty and disease. It, in a few cases, as we have evidently seen that a few countries and economies have transformed from aid recipients to aid donors in less than 50 years. Unlike the common perception that development aid is a large part of rich countries' budgets, an acknowledgement that no program is perfect and that there are ways to make aid more effective plays an important part in addressing the relationship between aid and growth. With the support of the analysis on the nature of developmental aid provided in this paper, one can infer that

aid is only one of the tools for fighting poverty and disease." *Wealthy countries also need to make policy changes, like opening their markets and cutting agricultural subsidies, and poor countries need to spend more on health and development for their own people.*" (Bill and Melinda Gates, Annual letter 2014).

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