FOREIGN AID DECREASE – THREAT FOR MILLENNIUM DEVELOPMENT GOLAS?[16]

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Abstract

This paper investigates the relationship between foreign aid and growth in real GDP per capita in Africa in the period 1980 – 2012 using regression. It examines whether foreign aid flows have any effect on the effectiveness of foreign aid and Millennium Development Goals. The results show that the effect of aid on economic growth in Africa is not significant. The paper concludes that the quantity of foreign aid flows is not a significant determinant of GDP growth in Africa. The recent decrease of foreign aid flows should not poses any threat to achieving Millennium Development Goals.

Keywords: Aid Effectiveness, economic growth, regression analysis, Africa, millennium development goals

Introduction

The international dispute concerning Official Development Assistance (ODA) has increased significantly over the last decade. This has been caused largely by recent economic and financial crisis and by the international attention towards achieving Millennium Development Goals in 2015. The debate on the effectiveness of foreign aid is still ongoing as there is no clear consensus between the scholars whether or not foreign aid is effective in promoting growth in recipient countries.

African continent is one of the major recipients of ODA since 1960. The largest proportions of ODA are channeled to Sub-Saharan Africa. The level of ODA to Africa doubled over last 10 years. Africa is the continent where most LDCs are located but unfortunately where most countries “off track“ towards the MDGs can be seen. The African continent has been widely criticized for misusing the foreign aid. This paper investigates aid-growth relation at the macro level as it emerges from regression using large data sets (39 African countries, investigated period 1980 – 2012).

The previous literature relies on three different views identifying the effects of aid on growth: there is no relationship (or negative); a positive relationship (usually with diminishing returns); or a conditional relationship in which aid works in some circumstances depending on the procedures of the recipient country or the donors’ practice. Griffen and Enos (1970) found negative correlation between aid and growth in 27 countries. Many scholars followed and showed a negative relationship between aid and growth (Mosley, 1980; Mosley et al, 1987; Dowling and Hiemenz, 1982; Singh, 1985; Boone, 1994). Several studies found a positive relationship between aid and growth (Papanek, 1973, Levy 1988). Positive relationships have been found by scholars investigating whether aid might spur growth with diminishing returns (Hajimichael, et. al, 1995; Durbarry et al, 1998; Dalgard and Hansen, 2000; Hansen and Tarp 2000 and 2001; Lensink and White, 2001; and Dalgaard, et al, 2004). The third view representing conditional relationship in which aid works in some circumstances depending on

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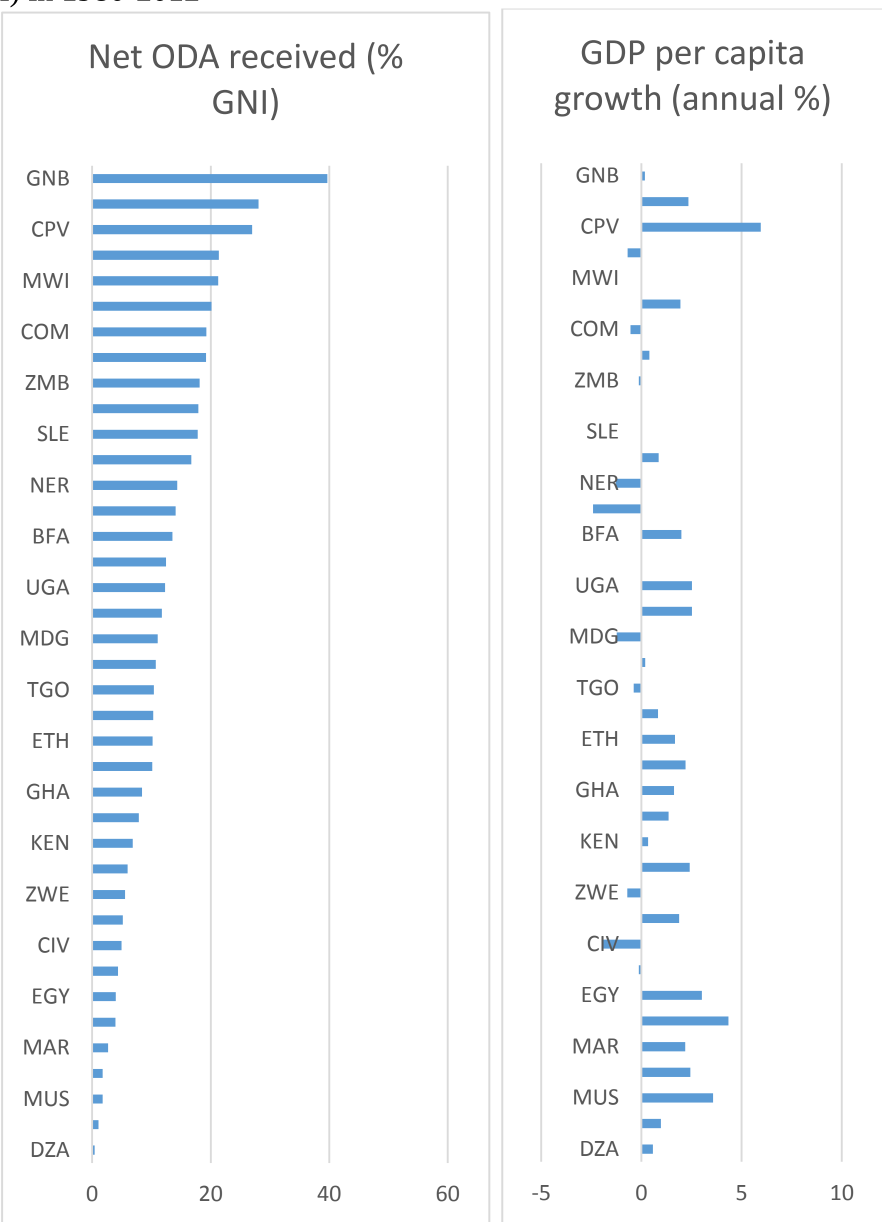
the recipient and the donor characteristics was supported by (Isham, Kaufmann, and Pritchett, 1995; Burnside and Dollar, 2000; Collier and Dehn, 2001; Dalgaard, 2004).

According to statistics there are many reasons to expect that there is a negative relationship between aid and growth in Africa; therefore we turn to empirics to answer this question.

Causality between aid and growth in Africa

In our research we set two hypotheses: (1) There is no significant relationship between foreign aid and economic growth in Africa; (2) The African countries receiving the most aid do not show any significant growth. In our analysis we use the World Bank data (World Development Indicators) covering most African countries (39) in the period 1980 – 2012. Figure 1 provides a first impression of the data. The patterns are in line with our assumptions (hypothesis 2).

Figure 1 Causality between GDP per capita growth (annual %) and net ODA received (% GNI) in 1980-2012



Source: Calculated by the author using World Bank Data (World Development Indicators) <http://www.data.worldbank.org>.

We summarized the results of the above analysis into a table (Table 1). The criterion for indentifying the countries receiving the most aid was set to ≥ 15% of GNI. This criterion has been selected according to the Center for Global Development[17], which proves that if foreign aid reaches more than 15% GNI, it becomes ineffective and loses its motivation character.

Table 1 Causality between GDP per capita growth (annual %) and net ODA received (% GNI) in 1980-2012

Country	Net ODA received (%GNI)	GDP per capita growth
1. Guinea - Bissau	40%	0,20%
2. Mozambique	30%	2,40%
3. Cape Verde	27%	6%
4. Burundi	21%	-0,70%
5. Malawi	21%	-0,03%
6. Rwanda	20%	2%
7. Comoros	20%	-0,50%
8. Mauritania	20%	0,40%
9. Zambia	18%	-0,10%
10. Gambia	18%	0,00%
11. Sierra Leone	18%	-0,03%
12. Mali	17%	0,90%
13. Niger	15%	-1,30%
14. Democratic Republic Congo	15%	-2,40%

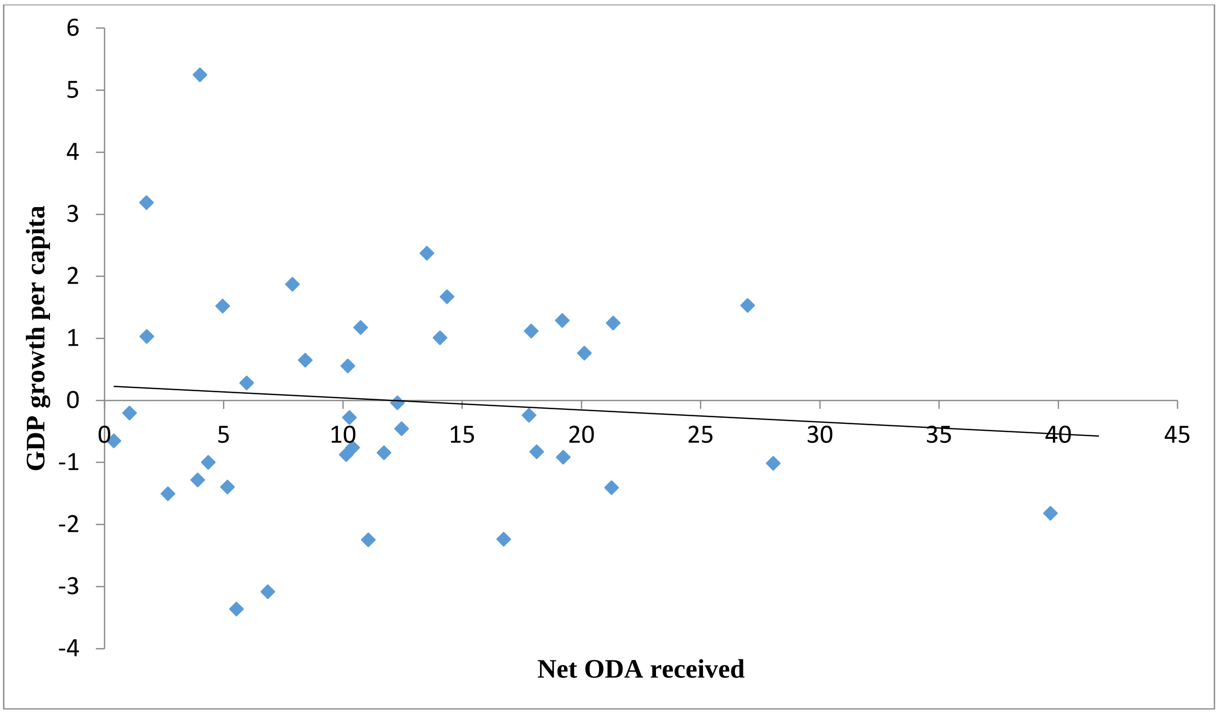
Source: Calculated by the author using World Bank Data (World Development Indicators) <http://www. data.worldbank.org>.

The analysis shows, that the foreign aid effectiveness is not significantly determined by economic growth in African countries. The countries which received the most foreign aid (as a percentage of GNI) show negative or very low economic growth. The only exception is Cape Verde that shows GDP growth per capita 6% while receiving foreign aid of 27% of GNI. The results suggest that the African countries receiving the highest share of aid have negative or very low economic growth. In summary, we can conclude that the hypothesis 2 can be accepted. In terms of increasing the effectiveness of aid we conclude that the foreign aid might overarch the absorbing capacity of the countries (the ability of the countries to use the foreign aid effectively). We suggest decreasing the level of foreign aid under 15 % of GNI.

Further, we used regression analysis to determine the relationship between the net ODA and GDP per capita growth. Graphical representation of the regression analysis is presented in the figure below (Figure 2).

[17] ROODMAN, D. 2006. Aid Project Proliferation and Absorptive Capacity. Centre for Global Development Working Paper 75. Washington: Center for Global Development.

Figure 2 Regression analyses between net ODA and GDP per capita growth (1980 – 2012)



SUMMARY OUTPUT

Regression Statistics	
Multiple R	0,096121
R Square	0,0092393
Adjusted R Square	-0,0175381
Standard Error	1,7402264
Observations	39

Source: Calculated by the author using World Bank Data (World Development Indicators) <http://www.data.worldbank.org>.

The Pearson coefficient is very low (0,096), the X and Y variables are independent. R square equals to 0, 0092 (R^2 indicates that 0, 09 % of GDP growth is correlated to the growth of foreign aid). The regression analysis shows that there is a negative relationship between growth and aid. As a result, the first hypothesis can be accepted.

Conclusion

Despite the fact that the financial crisis started in the West, the developing countries are being affected in many ways. The ODA levels reached its peak in 2010, but decreased by -2.7 % in real terms compared to 2012. This drop was caused by the financial constraints in several DAC countries which have affected the ODA budgets. Bilateral aid to sub-Saharan Africa in 2012 was USD 28.0 billion, representing a fall of -0.9 % in real terms compared to 2011.

Some economists are warning of “lost decades for development” which could have negative consequences for rich and poor countries alike. The World Bank described the crisis as a “development emergency”.

Such aid statistics always impose a threat for achieving Millennium Development Goals in 2015. But is it really ODA volumes that matters? Our regression statistics show that there is a negative causality between foreign aid and GDP growth per capita since 1980. Despite the fact that the ODA volumes increased significantly since 1980, this masks the extent to which relatively little aid actually reaches recipient countries.

The evidence shows that aid has little impact on development outcomes and the MDGs. The international efforts such as Paris Declaration and Accra Agenda for Action aim to improve the effectiveness of ODA. Progress, however, has so far been very little.

In summary, we can conclude that donors provide aid for a variety of reasons not necessarily related to poverty reduction and the MDGs. On the recipient country side, much aid has been wasted and misused. We recommend monitoring recipient and donor countries practices in order to increase the quality and the effectiveness of foreign aid.

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