

## Foreign Aid



# Learning Objectives

## Specific Expectations

AO2	Distinguish between humanitarian aid and development aid.
AO3	Explain and evaluate foreign aid in the form of: Official Development Assistance (ODA), non-governmental organisations (NGOs), and debt relief.
AO3	Explain and evaluate the roles of: the World Bank, and International Monetary Fund (IMF).
AO3	Explain and evaluate strategies to: <ul style="list-style-type: none"><li>- Improve access to banking (microfinance, mobile banking)</li><li>- Increase women's empowerment</li><li>- reduce corruption</li><li>- establish property</li></ul>

# Foreign Aid

- **Foreign Aid** the transfer of funds or goods and services to developing countries with the main objective to bring about improvements in their economic, social or political conditions. Such transfers must be:
  - ▶ **Concessional** – loans must be on more favourable terms than a bank would give.
  - ▶ **Non-commercial** – must not be involved with buying and selling activities concerned with making a profit.
- **Humanitarian Aid** is foreign aid extended in regions where there are emergencies and is intended to save lives, ensure access to basic necessities and provide assistance with reconstruction.
- **Development Aid** is foreign aid intended to help economically less developed countries with their growth and development efforts.

# Official Development Assistance (ODA)

- **Official Development Assistance (ODA)** is the most important part of **foreign aid**, referring to foreign aid that is offered by countries or by international organizations composed of a number of countries (it does not include aid offered by non-governmental organizations).
- ODA funds reach developing countries in three ways:
  - ▶ **Bilateral aid** – funds go directly from the donor government to the developing country recipient.
  - ▶ **Multilateral aid** – funds go indirectly from donor governments to international organizations, which transfer the funds to developing country governments.
  - ▶ **NGOs** – donor governments transfer ODA funds to NGOs which spend them in developing countries.

# Official Development Assistance (ODA) - Advantages

- Arguments in favour of Official Development Assistance (ODA):
  1. **Funding to break the poverty cycle**
    - Foreign aid provides necessary funds for investment in health care, education, and basic infrastructure.
  2. **Improved income distribution**
    - Focusing on the most disadvantaged groups in society can help improve the relative income positions of the beneficiaries and contribute to improved income distribution.
  3. **Economic growth**
    - Increased investment and consumption levels leads to increased volumes of output.
  4. **Sustainable Development Goals (SDGs)**
    - The provision of aid is crucially important to the achievement of the Sustainable Development Goals (SDGs).
  5. **Debt trap**
    - Aid for debt relief helps countries reduce their debt burden and releases resources that can be used for poverty reduction and economic growth and development.

# Official Development Assistance (ODA) - Disadvantages

- Limitations of Official Development Assistance (ODA):

1. **Tied aid**

- Donors make the recipients of aid spend all or a portion of borrow funds to buy goods and services from the donor country.

2. **Conditional aid (Conditionality)**

- Most donors of ODA impose numerous conditions that must be met by the recipients of aid.
- Donors see these conditions as a mechanism for forcing developing countries to make important policy changes, as well as for ensuring that aid funds are used effectively.

3. **Aid volatility and unpredictability**

- Difficult for recipient governments to implement policies that depend on aid funds, as they cannot be sure if and when funds will be available to undertake necessary investments and activities.

## 4. Uncoordinated donors

- Large number of donors (bilateral and multilateral) who finance uncoordinated activities, giving rise to numerous inefficiencies in the use of aid resources.

## 5. Substitute for domestic resources

- Aid is intended to supplement insufficient domestic resources.
- Governments in recipient countries may use aid funds to substitute for domestic resources, and not make enough effort to increase domestic revenues through taxation.

## 6. Difficulties reaching most disadvantaged

- Aid resources are not allocated on the basis of the greatest need for poverty alleviation.
- Donors do not allocate aid resources according to country needs, focusing instead on promoting their own interests.

## 7. Corruption

- Corruption involves the misuse of aid funds by recipient countries.
- Reflection of the degree of transparency and accountability in public affairs, and tends to be more prominent the lower the per capita income of a country.

## 8. Quantity of aid and poverty alleviation

- ODA funds are far less than the target amount
- Limits ability of developing countries to make investments in health, education and infrastructure needed to improve welfare and support the economy on the scale required to achieve the SDGs.



# Non-Governmental Organizations (NGOs)

- **Non-governmental organizations (NGOs)** are non-profit organizations that provide a wide range of services and humanitarian functions.
  - ▶ Involve **concessional flows** that are all in grants, so there are no loans that must be repaid.
  - ▶ Bilateral and multilateral donors of ODA are increasingly channelling their funds through NGOs because of their ability to perform some functions better than developing countries.
  - ▶ **Example(s):** Amnesty International, Greenpeace, & Oxfam
- Advantages of NGOs:
  1. **Strong anti-poverty oriented activities**
    - Work very closely with communities of poor people and responding to their particular needs as these arise in their own particular economic, social and environmental conditions.

# Non-Governmental Organizations (NGOs)

## 2. Working closely with project beneficiaries

- Work closely with beneficiaries, involving local people in the design and implementation of development projects.

## 3. Contributing to democratization, advocacy and raising public awareness and support.

- Leadership role in acting as advocates on public policy issues, and ensuring that poor people's concerns are heard.

## 4. Offering expertise and advice

- NGOs accumulate experience from a variety of countries and local settings, many of which may be relevant and transferable to similar settings in other countries.

## 5. Trust of beneficiaries

- NGOs often enjoy greater trust with governments, because of their close relationship with project beneficiaries, and their commitment to solving problems at grassroots level.

# Non-Governmental Organizations (NGOs)

- Disadvantages of NGOs:
  1. **Small size and weakness of many NGOs**
    - NGOs have limited resources, and may face difficulties in attracting skilled personnel, so the effectiveness of their projects may be limited.
  2. **Dependence of governments & aid agencies for funding**
    - Often rely on outside sources for funding, so they may lose their independence if they are forced to conform to funders demands.
  3. **Deprive government of qualified personnel**
    - Growing role of NGOs in development creates a demand for technical experts and personnel that may deprive governments of personnel.
  4. **Challenge to state authority**
    - Governments often dislike the advocacy role take on by many NGOs which may conflict with government policy or question its authority.

# Debt Relief

- **Debt relief** refers to the cancellation or forgiveness of all or a portion of a country's debt.
  - ▶ “Assist developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief, and debt restructuring.”
  - ▶ Frees up resources that can be spent for development purposes including infrastructure, health services and education, creating new jobs, and providing family planning services.

# Multilateral Development Assistance

- **Multilateral development assistance** is lending to developing countries for the purpose of assisting their development on non-concessional terms (market rates of interest and repayment periods) by multilateral organisations.
- **World Bank** is a development assistance organization that extends long-term loans to developing country governments for the purpose of promoting economic development and structural change.

Evaluating the role of the World Bank:

## 1. Social and environmental concerns

- Criticised for implementing socially unsound projects, as well as environmentally unsustainable projects.

## 2. Rich country dominance

- Voting power in its governance is determined by the size of financial contributions made by each country to the organization.

## 3. Excessive interference in countries' domestic affairs

- Criticised for interfering excessively in the domestic policy affairs of developing countries.

## 4. Conditional assistance/lending

- Conditional assistance refers to the imposition of conditions that must be met by borrowing countries to qualify for a loan.
- It is problematic because it deprives countries control over their domestic economic activities.

## 5. Inadequate attention to poverty alleviation

- Lack of funds for loans intended to meet the needed investments in education, health services, and infrastructure.

## 6. Excessive focus on market-based supply-side policies

- Focusing excessively on free-market reforms, ignoring the negative consequences.

# Multilateral Development Assistance

- **International Monetary Fund (IMF)** an international financial institution, whose purpose is to make short-term loans to governments on commercial terms (non-concessional) in order to stabilize exchange rates, alleviate balance of payment difficulties and help countries meet their foreign debt obligations.

Evaluating the role of the International Monetary Fund:

1. **Governance dominated by rich countries**

- Voting power in governance is in proportion to the size of each economy, giving rich countries far greater power in decision-making.

2. **Excessive interference in countries' domestic affairs**

- Significant interference in domestic economies

3. **Conditional lending (conditionality)**

- Countries have been forced to accept harsh conditions running counter to their growth and development objectives.

## 4. Damaging effects on developing countries

- Stabilization policies have the impact of lowering economic growth, often creating a recession with increasing unemployment and increasing levels of poverty.

## 5. Stabilization policies based on a flawed concept

- The IMF programme has often resulted in countries experiencing increasing poverty, lower or negative rates of growth, and unable to “grow” out of their balance of payments difficulties or external debt problems.



- **Microfinance (microcredit)** programmes to provide credit (loans) in small amounts to people who do not ordinarily have access to credit due to a lack of collateral.
  - ▶ These are very important in developing countries as a strategy to help poor people climb out of poverty.

## Evaluating issues in microfinance

### 1. **Substitute for needed government anti-poverty policies**

- Microcredit may be viewed as a substitute for other, complementary government policies needed to combat poverty that are the responsibility of the public sector.

### 2. **Microcredit schemes contribute to growth of informal economy**

- Micro-enterprises that are created through microcredit operate for the most part in the informal economy, which is unregulated, where workers have no social protection, & exploitative conditions often prevail.

### 3. Most vulnerable may be harmed by microcredit

- The poorest of poor usually lack skills necessary to begin a micro-enterprise such as basic literacy and numeracy skills.
- In such cases, microcredit may end up burdening some extremely poor people with payments on loans that cannot produce a stable source of income.

### 4. Interest rates in microcredit schemes are too high

- Interest rates in microcredit schemes tend to be higher than market rates of interest.
- The costs of providing very many, very small loans are higher than the cost of providing fewer larger loans.
- Some economists argue that high interest rates should be subsidized to make repayment easier for poor people.

# Women's empowerment

- Women's empowerment has enormous effects on growth and development, extending beyond women themselves.
  - ▶ These external benefits can be thought of as consumption externalities of women's health and education, analysed as standard health and education externalities.

## 1. Improved child health & nutrition and lower child mortality

- Increased education of women has major positive effects on the health of children, because of improved knowledge about health, health services, basic hygiene and nutrition.

## 2. Improvements in educational attainment of children

- Mothers have a major influence over the education of their children, and studies show that the more educated the mother, the more educated the children.

## 3. Quality of human resources

- The impacts of increased education and incomes of women on the levels of health and education of their children have enormous cumulative effects on the quality of human resources in a country that extend over many years, with the potential to affect profoundly the course of economic growth and development.

## 4. Lower fertility (lower birth rates)

- Increased education of women, more and better work outside the home, and higher incomes leads to having fewer children, because of later marriage and greater reproductive choice, and therefore lower population growth, with all its related benefits.

# Reducing corruption

- The problem of corruption is a barrier to growth and development.
- The fight against corruption requires strong fiscal institutions that promote integrity and accountability throughout the public sector.
  - ▶ Develop high level of transparency and independent external scrutiny which allows audit agencies and the public to provide supervision.
  - ▶ Reform institutions of tax administration.
  - ▶ Focus on area where there is higher risk of corruption, such as procurement, revenue administration and natural resource management.
  - ▶ Establishing institutional and incentives to prevent corruption from occurring.
  - ▶ Creating mechanisms that discourage corruption by providing penalties and sanctions.
  - ▶ Influencing the development of perceptions of the type of governance needed for long-term efforts to fight corruption.

# Property and land rights

- The establishment of property rights that takes the form of titling to property is important for growth as it encourages investment and facilitates credit that allows investment to increase.
  - ▶ Contribute to food security as they improve sustainable land use, improve access to credit, and increase productivity of small farmers.
  - ▶ Lead to lower rates of deforestation
  - ▶ Preserve diverse food cultures and biodiversity
  - ▶ Support indigenous peoples and improve their economic and social status.