Does Foreign Aid Do More Harm Than Good ? Essay, Research Paper

The dictionary definition of the term ‘foreign aid’ is: “The administered transfer of resources from the advanced countries for the purpose of encouraging economic growth in developing countries.” [Bannock:1988 P.164] However, so as not to confuse foreign aid with the investments of multinational corporations or commercial banks, many economists require foreign aid to meet two distinct criteria: 1) Its objective must be noncommercial from the point of view of the donor and 2) it should be characterized by concessional terms. There are many ways and means of transferring resources to LDC’s (Less Developed Countries): Multilaterally, as with the many international agencies such as the World Bank or various departments of the United Nations. Bilaterally, which is an agreement between two countries for a specific amount or item of aid. Direct food aid, or, the granting of preferential tariffs by developed countries to Third World exports of manufactured goods. However, the evaluation of the effects and purposes of foreign aid has become a subjective and value-laden minefield, with many commentators simply picking out the facts which suit their particular ideological perspective. In this essay we will assess how the different forms of foreign aid affect LDC’s, examine the opposing theories of dependency and modernization in relation to development assistance, and finally, question whether the current forms of foreign aid are maximizing their utility. With the Marshall Plan and the dramatic european recovery still fresh in every politicians minds, the idea of foreign aid began to be attractive to both donor and recipient during the 1950’s. In this decade the ex-colonies began to ralize just how dependent they still were on the former imperial powers. The USA, plus the major european nations believed that providing foreign aid would not only allow a measure of continuing control over their former charges, but also help contain the threat of communism. It was in these circumstances, with no doubt large amounts of altruism and high hopes for ending poverty, ignorance and disease, that the aid merry-go-round began. Figures kept between 1960 and 1986 show that ODA (Official Development Assistance) has increased from an annual rate of $4.6 billion in 1960 to more than $37 billion in 1986. These figures include bilateral/multilateral grants, loans, food and technical assistance. The statistics, however, are misleading as in real terms there has been a steady decline since 1960 in the actual percentage of developed country GNP’s (Gross National Product) devoted to ODA, from an overall percentage of 0.51% in 1960 to 0.36% in 1986. The United Nations recommends a minimum of 0.7% of GNP from developed nations towards ODA. In a recent study of contributions to ODA by developed countries only five of the eighteen studied managed to reach and pass this figure. They were, in order of ranking: Norway (1.03%), Netherlands(0.91%), Sweden(0.86%), Denmark(0.80%) and France(0.78%). The United Kingdom was twelth with 0.34% of GNP devoted to development assistance of all forms, while the USA came bottom of the table with 0.24% of GNP going towards foreign aid. However, besides Japan, the USA remains the largest donor in real terms with contributions totalling 24% of all ODA. [Source:Todaro,P.483) As pointed out earlier foreign aid takes many forms and constituted roughly one third of all capital flows to the LDC's during the 1980's, the other two thirds consisting of private bank loans and investment by multinational companies. We will now look at the different forms of development assistance available to the LDC's. BILATERAL AID Bilateral aid is the direct transfer of specific resources or money between two countries. Many of the industrialized nations in the West have their own official development agencies, the largest being the United States AID(Agency for International Development) UK aid is administered by the Overseas Development Administration. Bilateral aid is rarely an outright grant of money, it is usually a low interest loan. However, in the majority of cases it is a 'tied loan', this means that the recipient of the loan is required to purchase goods and services from the donor country. For example: the British Overseas Development Administration may decide to extend a tied loan to the government of Ghana for the construction of a steel mill. Under the terms of the agreement the Ghanian government will have to buy all the materials and technical assistance for the construction of the project from British manufacturer's. In the words of a former British minister for overseas development 'trade follows aid'. MULTILATERAL AID Most multilateral aid is channelled through the World Bank,the IMF and various agencies of the United Nations. (The IMF is something of a misnomer here as its loans are rarely concessional, but it is still regarded as an important adjunct of development.) The two main agencies, the World Bank and the IMF, claim that their international status makes them totally objective and so enables them to make value free decisions on the distribution of ODA. Their stated aim is to promote and implement economic policies favourable to development. To this end, especially during the 1960's and 70's, many of the their lending policies were directed towards the economic infrastructure of a country, such as the development of transport, communications and power systems. Preceding and following the publication of the Brandt Report (1980) there was a noticeable shift, especially by the World Bank, in policies relating to development assistance. The aim was to redirect the emphasis of international aid away from capital intensive projects in order to help the rural and urban poor. To this end a higher proportion of World Bank funds was spent on agriculture, education, health and the provision of technical assistance. The IMF and the World Bank are held in great esteem by private lending institutions and have been referred to as the 'police of development'. Other official and private lenders tend to lend or not ot lend according to whether the government in question has the approval of these two agencies. This gives them a great amount of leverage when negotiating economic policy decisions with developing nations. FOOD AID AND FAVOURABLE TARIFFS The United States AID (Agency for International Development), through its 'Food for Peace' programmes, is the main purveyor of the direct export of food to underdeveloped nations. This policy has been criticized in certain quarters as some commentators believe that it creates a dependency culture, distorts the local markets and provides a disincentive to agricultural programmes for greater self-sufficiency. Another aspect of food aid is the 'green revolution' where hybrid strains of food crops have been developed by some western nations so that the cereals would grow faster and be more productive. TARIFFS: The last form of aid, and the least used, is the practice of granting preferential tariffs to LDC's, this enables Third World manufacturer's to sell their products in developed country markets at higher prices than would otherwise have been possible. This practice represents a net gain for LDC's and a net loss for developed countries, however, this is a practice which is rarely used. Before moving on to critically examine the motives and consequences of the Western aid programmes, in relation to thedependency and mordenization theories, we will briefly sum up the the forms of ODA available to newly industrializing nations (NIC's) and the LDC's. All developed western nations have agencies for overseasassistance, these agencies enter into agreements with LDC's, usually based on a tied-loan scheme. Multilateral agencies are funded by developed nations and involve themselves in large scale programmes and funding operations often prompting significant alterations in the economic policy and structure of the recipient nation. Food aid is the direct shipment of food to badly underdeveloped countries, the European Community and the United States are major participants in these schemes. Preferential tariffs on manufactured goods are extremely beneficial to LDC's but rarely used. The OPEC (Organization of Petroleum Exporting Countries) group of nations also participate in ODA, but on strictly bilateral lines. As the OPEC countries have no significant industrial or agricultural base, their assistance takes the form of direct cash loans or grants and is usually limited to the less developed countries of the Arab world. As well as the many national and international agencies for the provision of foreign aid there are a number charitable organizations which provide relief and technical assistance throughout the Third World. All of these agencies are the main channel for the transfer and distribution of economic resources to the less developed nations of the world. The raison d'etre of ODA is to facilitate economic growth by supplementing investment opportunities and overcoming restrictive bottlenecks in the domestic economy. "In macroeconomic terms foreign aid performs two functions: it adds to resources available for investment and it augments the supply of foreign exchange to finance imports." [Eatwell:1987 P.140] In this next section we will examine two diametrically opposed opinions which come out firmly against foreign aid, albeit for totally different reasons. The first is championed by Professor Bauer, who believes that ODA distorts the domestic market, while the second opinion is a product of the dependency school and argued rather eloquently by Teresa Hayter. Professor Bauer was the earliest and most vehement critic of development aid. His hypotheses refutes the accepted notion that comprehensive central planning, plus substantial amounts of ODA, could break the vicious circle of poverty, low savings and low investment and thus launch a country into sustained economic growth. Bauer points to the fact that virtually all of the industrialized nations have achieved prosperity without central planning or foreign aid and that given stable economic and political conditions, even very poor countries could generate productive savings and investment opportunities. Basically Bauer is an advocate of supply-side economics, and strongly believes that aid inhibits growth while strenghtening the governments control over the economy, inevitably leading to premature industrialization behind high trade barriers and promoting corrosive influences in political and economic life. Here is a characteristic statement of Bauer’s position: “Foreign aid… cannot appreciably promote the growth of national income. It promotes the disastrous politicisation of life in the Third World. People divert their resources and attention (because of aid) from productive economic activities into other areas, such as trying to forecast political developments, placating or bribing politicians and civil servants, and operating or evading controls.” [Mosley:1987 P.241] However, one could suggest that Professor Bauer was merely pickingout certain facts to support his own ideological viewpoint. There are many instances of governments becoming heavily involved in the running of the economy, often with great success: Costa Rica, Brazil, Taiwan and South Korea to name but a few. Certainly, some aid programmes have crowded out domestic investment, raised internal prices and distorted the labour market to the detriment of the local producers, but the long-term benefits of, for example, a road-building programme, could be construed as outweighing its short-term costs. There is also the point that private investors, whether domestic or foreign, would not want to get involved in many of the public programmes that are funded by ODA, and that governments in the very poor countries could not afford to borrow on commercial terms to fund these projects. Finally, Bauer’s assertion that foreign aid stifles local entrepreneur’s and leads to the corruption and centralization of political life is a claim that is difficult to substantiate with any hard empirical evidence. Indeed, both India and Bangladesh, who were recipients of substantial amounts of foreign aid during the 1970’s, actually privatized parts of their industrial sector, liberalized controls on foreign trade and dismantled some marketing boards. To sum up, Bauer believes that all foreign aid is simply the avoided ‘cost of borrowing’ which leads to essentially unproductive, inefficient practices, and displaced social goals. The modernization process is disrupted by the suppression of the informal economy, the curtailment of import-substitution and the general fostering of a social and political atmosphere in which ODA discourages domestic entrepreneurship. However, Bauer’s view is essentially narrow, and does not take into account the benefits accrued from foreign aid inputs into education, health, social welfare and general infrastructure programmes, which the private sector cannot supply. Thereby leaving a government with limited financial resources no other option but to seek help from abroad in order to develop its domestic economy. Therefore, we can conclude that ODA, according to Professor’s Bauer’s criteria, is more positive than negative. While the modernization theories highlight the adverse effects of foreign aid from a domestic, microeconomic perspective, Hayter and other dependency theorists believe that ODA is used on a global scale to advance the interests of the core industrialized nations at the expense of the periphery. Hayter’s view is that foreign aid is given by donor countries because it is in their political, strategic or economic interest to do so. Ever since the 1950’s American economic and military aid has flitted all over the globe, contriving to prop up shaky and often brutal regimes in an attempt to halt the threat of communist expansion. The Soviet Union and China have also indulged in these political/strategic practices as to a lesser extent have France and Britain. Aid is seen as a means of punishing enemies, rewarding friends and enticing non-committal governments into the Western fold. However, it is the economic justifications of providing aid to the Third World which take on the most sinister motives. The bi-lateral loan-tied schemes, which are the most common form of aid between a developed and undeveloped nation, are viewed primarily as a means of opening up new markets and/or selling otherwise uncompetitive products. Once a recipient nation has imported a piece of capital equipment, which may well be inappropriate to its needs, it will invariably need continued technical assistance and spare-parts from the original donor. Furthermore, aid can be used as a means to support uncompetitive tendering from a foreign firm in the domestic market of an LDC, where otherwise the materials and skills would have been provided by local sources. Evidence for this was provided when Bharat Heavy Electrical (BHEL), India’s state-owned power station contractor, was overtaken by GEC due to the fact that the UK Government subsidized GEC’s bid with a grant of money. [Source: Hayter 1990 P.242] Likewise, the policies pursued by the World Bank, of installing economic infrastructures such as transport, communictaions and power systems, could be cynically viewed as being necessary for the profitable operation of a multinational taking advantage of cheap labour, or foreign mining companies and agribusinesses exploiting natural resources. It would seem,therefore, that “the export of capital thus becomes a means for encouraging the export of commodities.” [Hayter:1981 P.73] The structural adjustment loans provided by the multilateral agencies are seen as an attempt to lock the developing countries into the world-wide capitalist system and ensure their markets remain open to exports of manufactured goods, while inhibiting nascent industrial bases which would benefit from some measure of tariff protection. To sum up, the theories put forward by Hayter are nothing short of a global conspiracy theory. The industrialized countries, through their own aid programmes and the multilateral agencies, help to maintain a world economic and political order which is subordinate and necessary to their own survival. Through the judicious dispersal of aid money, Third World elites are kept in power who can pursue, or are forced to pursue, policies favourable to the West. Even development assistance which has contributed to the rise in health care, education and social welfare, is seen as an attempt to quell local unrest and halt any undue movement towards a revolutionary socialist government which would nationalise the factors of production. However, it is difficult to see how these aims are ultimately to benefit the industrialized nations. The declining prices of commodities, in relation to manufactures, will eventually kill the ‘goose who lays the golden egg’. Many LDC’s can also choose from a plethora of donor nations, each eager to gain a foothold in the recipient’s country. Due to fungibility, and the Byzantine workings of Third World bureaucracies, the multilateral agencies find it almost impossible to dictate the exact destination and outcome of their investments. In fact, as long as the LDC’s agree in principle to the demands of the World Bank, or the IMF, they have great freedom in how they spend the aid and run their public sector’s. This, of course, is not an indication of whether the aid does more harm than good, it is more an indication that foreign aid cannot be used solely to further the interests of the industrialized nations to the detriment of the recipients. Therefore, we can reject the supposition that ODA is simply a form of neo-colonialism, designed to perpetuate the dependency of the former colonies within the capitalist-imperialist system. Rather, it has become a transfer of resources which serves many aims and many masters, which inevitably detracts from its utility. In this essay we have examined two arguments which come out firmly against foreign aid. Professor Bauer believes that ODA creates a dependency culture which disrupts the natural modernization processes, and so hinders an economies ability to compete effectively in the world market. While Teresa Hayter argues that the foreign aid is just one weapon in the armoury of the advanced nations used to continue the dependency relationship, which can only be ended by the LDC’s removing themselves from the capitalist system. These theories have evolved from the many criticisms levelled at foreign aid since its inception during the 1950’s. Development assistance has been accused of solving old problems only to create new difficulties in their place. For instance: Policies of industrialization appeared to succeed in boosting industrial output, but did so by increasing capital intensity which gave rise to intolerable unemployment rates. The so called ‘green revolution’ increased agricultural output but at the cost of the small peasant farmer, who was forced off his land and so created more unemployment and poverty and fuelled the stream of rural migration into the cities. The transfer and proliferation of inappropriate technology led to a constant demand for spare-parts and also added to the LDC’s energy requirements. The projects, equipment and loans granted bilaterally also reflected the conflict of interest on the part of the donor, who wanted to assist the recipients economic growth while achieving objectives of foreign and commercial policy. While the programmes offered by the multilateral agencies often rested on the asumption that “western systems can be grown in, or imposed upon, any culture and that the effective transfer of wealth from North to South requires little more than a bank operation.” [May:1981 P.194/198] Undoubtedly, the ‘backwash’ effects of certain foreign aid programmes and projects have damaged, or even retarded, some sectors and economies in the developing world. But, to use a medical analogy, because a patient doesn’t respond to a certain remedy, a doctor will not just stop the treatment. He will look around, try different cures, until something does work.Therefore, the greatest strength of ODA, and the bestreason for its retention, is the ability of its administrators tolearn from their mistakes and mould policy accordingly. This abilitywas highlighted by the Pearson and the Brandt Reports, which recognized that the existing policies of capital intensive economic growth were creating more problems than they solved. Thus the emphasis changed and policies were adopted to increase employment opportunities and to secure greater equity through the distribution of income. The value of foreign aid has also been damaged by the expectations and claims of its adherents; ODA is not, and never can be, a universal panacea for developmental problems, it can only be part of a much wider process. A process which seems to have succeeded in many parts of Asia and Latin America but yet to have much impact in Africa. Finally, how do we assess whether foreign aid has ‘done more harm than good’ in the Third World; to do so we would have to accept an all-embracing set of values and goals. This is extremely difficult, as there are as many reasons for giving and accepting foreign aid, as there are academics willing to interpret the motives and consequences against their own ideological yardstick. To sum up therefore, it is best to retain a minimalist and objective perspective. “Stripped to its bare essentials, the case for development aid is that it increases growth rates in some developing counries, improves the living standards of some poor people, and offers the propect of doing better in the future on both counts. That is all.”