Foreign Aid

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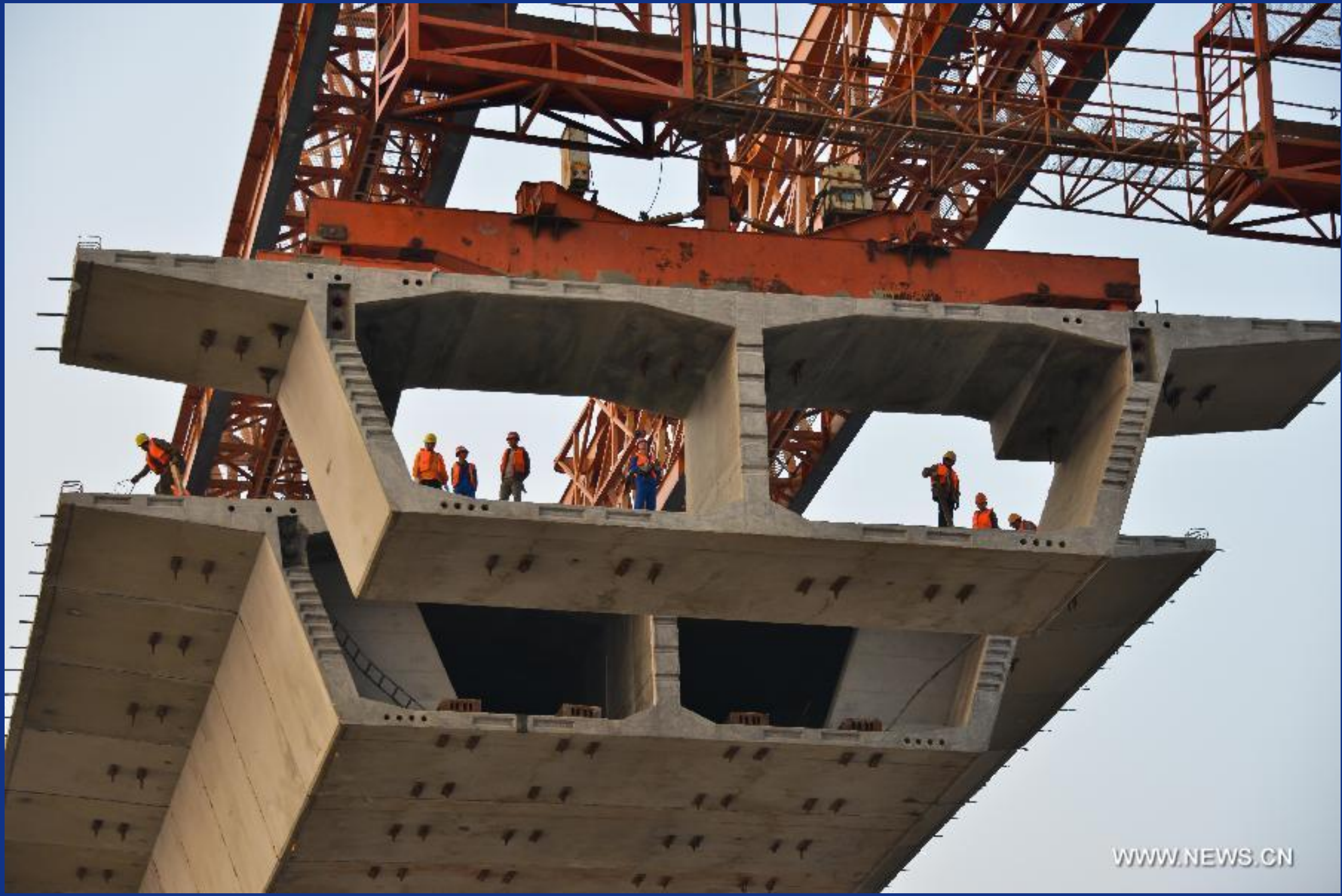
OVERVIEW

What is foreign aid?

Foreign aid is financial flow, technical assistance and commodities given by residents of one country to another country for development purposes

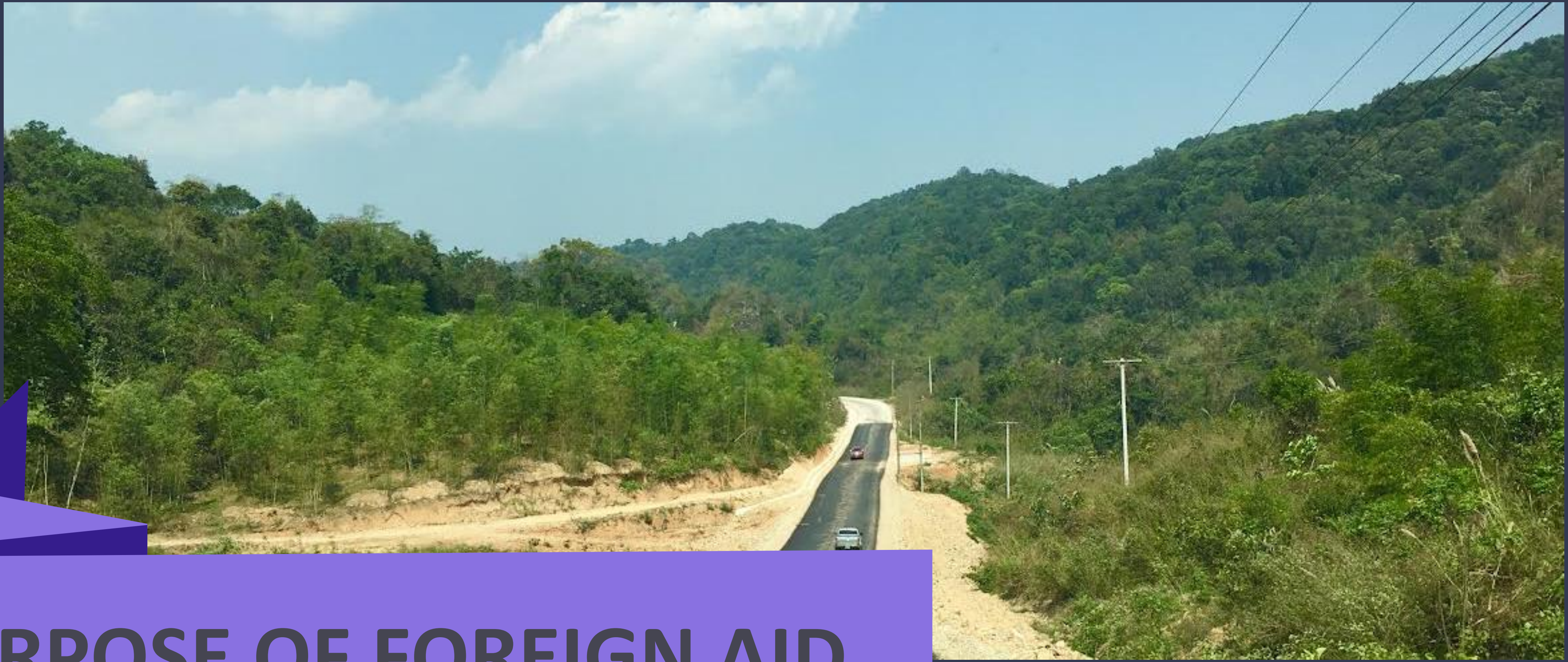
What is foreign aid?

- Foreign aid is also known as official development assistance (ODA)
- Modalities: loans, grants and technical assistance
- Sourced through multilateral or bilateral organizations



What is foreign aid?

- Not all financial flows and technical assistance can be considered as foreign aid
- Depends on who gives it, for what purpose, and the terms and conditions
- Commercial foreign lending, technical assistance for military purposes, and grants from religious groups are not foreign aid



PURPOSE OF FOREIGN AID

Purpose of foreign aid

- Stimulate economic growth through building infrastructure
- Support productive sectors, introduce new ideas or technologies
- Promote other development objectives, such as strengthening education, health, environment, or political systems

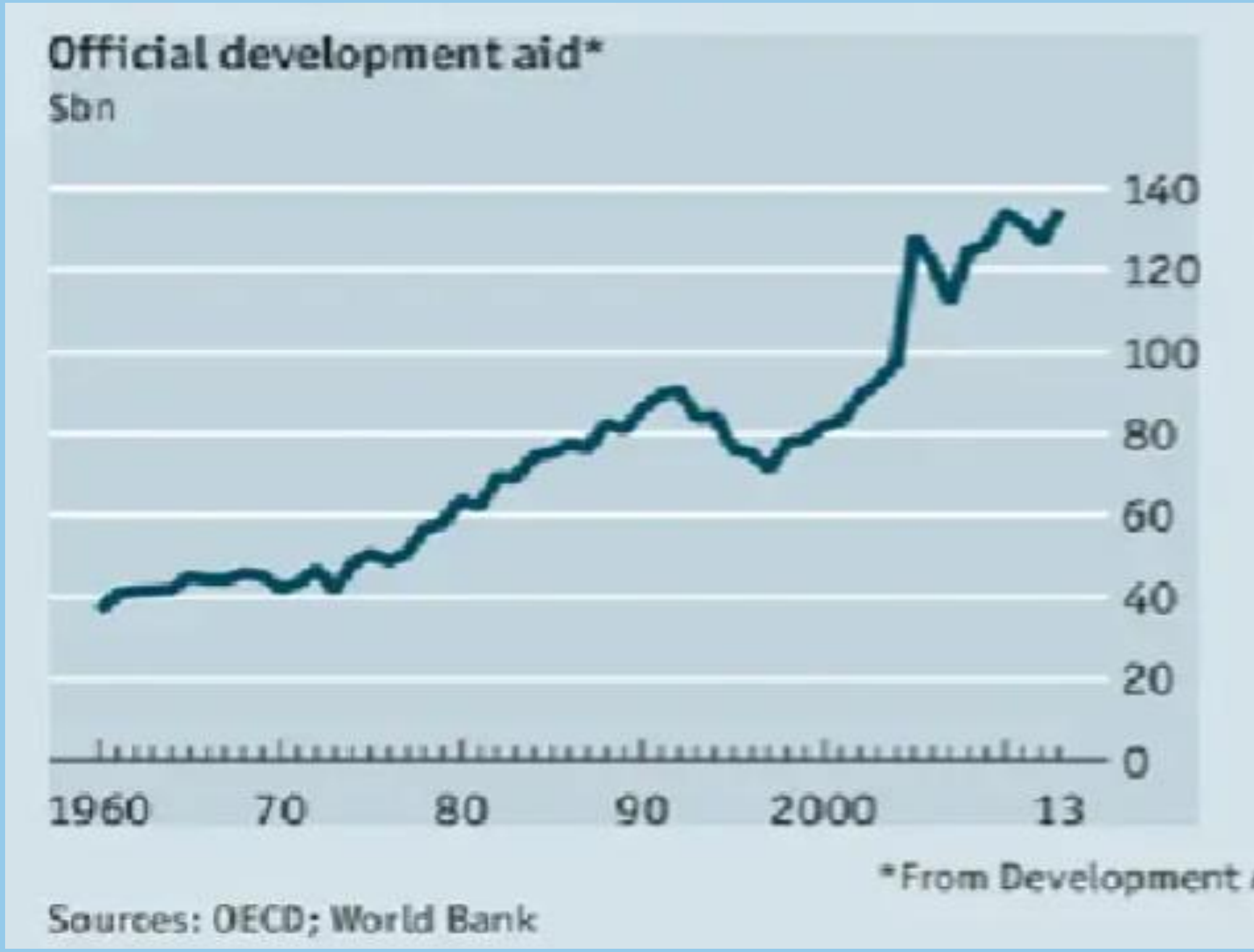
Purpose of foreign aid

- Support subsistence food consumption and other commodities, especially in emergencies after natural disasters or humanitarian crisis
- Help stabilize an economy after economic shocks

TRENDS IN FOREIGN AID

Trends in foreign aid

- Global aid rose steadily from the 1960s until it reached a peak of $90 billion in 1991, after the end of the Cold War
- Global aid declined in the 1990s and started to rebound in the early 2000s
- The global financial crisis in 2008 caused a decline in global aid but rebounded the following year



Bilateral aid

Bilateral aid: assistance directly from one country to another; government-to-government

Bilateral aid

- Supports recipient country governments (government-to-government)
- In some cases aid is disbursed through research organizations, universities, and not-for-profit organizations

Multilateral aid

Multilateral aid is assistance from international institutions which have pooled financial sources provided by their member countries

Multilateral aid

- Multilateral aid provides larger amounts of aid compared to bilateral aid
- Provides lower bureaucratic costs
- Requires fewer political ties

The World Bank

Largest multilateral aid donor, located in Washington, DC established in Bretton Woods in 1946 together with IMF and began as a reconstruction bank to aid Europe after WWII

The World Bank

- World Bank has favorable credit rating
- Borrows from world capital markets and relends to developing countries at slightly higher rates
- Funds are sourced from paid-in capital from member countries which are relent to poor countries

Asian Development Bank

Located in Manila and established in 1966 with 23 field offices, or resident missions: operates similar to World Bank, but focuses on the Asia-Pacific region

ASIAN DEVELOPMENT BANK

Asian Development Bank

- Sources funds from world capital markets and paid-in capital from member countries and relends it to poor countries
- Terms of loan repayment: 32 years with a grace period of 8 years and interest of 1% per year during the grace period and 1.5% per year thereafter

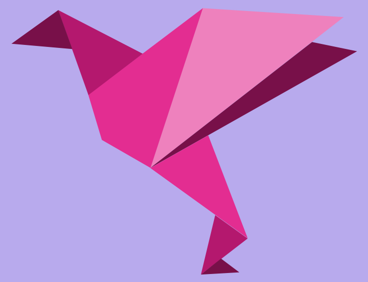
PERSPECTIVES ON FOREIGN AID

Debate on foreign aid

- Foreign aid enriches elites in recipient countries and therefore does more harm than good
- Reinforces corrupt practices and distorts incentives; example: widespread poverty in Africa and South Asia despite 4 decades of foreign aid
- Accelerates growth, reduces poverty helps achieve development objectives in countries unable to generate resources needed to finance investment; example: Marshall Plan

Aid and economic growth: View 1

Although not always successful, on average aid has a positive impact on economic growth and development



Aid and economic growth: View 1

- Aid promotes growth by financing new investments, especially investments in public goods such as roads, ports, electricity generation and distribution, schools and health facilities
- Aid promotes capital accumulation/ formation as driver for economic growth, and transfer of knowledge/innovation

Aid and economic growth: View 2

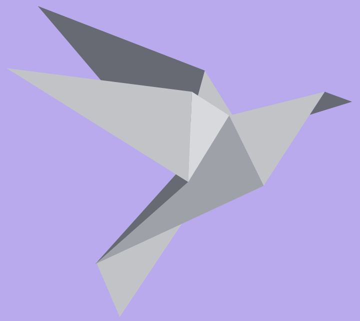
Aid has little or no effect on growth,
and could actually undermine growth

Aid and economic growth: View 2

- Aid is spent on large bureaucracies, expensive consultants and corrupt officials of recipient countries
- Aid is not effective if the absorptive capacity of recipient governments is low; implementers lack skills in managing aid
- Aid may crowd out the domestic private sector

Aid and economic growth: View 3

Aid has a conditional relationship with growth, stimulating growth only under certain circumstances



Aid and economic growth: View 3

- Depends on the characteristics of the recipient country and quality of institutions and policies
- Depends on the type of aid: short term (humanitarian assistance); medium term (infrastructure) or long term (education, health)

Aid and economic growth: View 3

- Depends on donor practices; multilateral aid is deemed more effective than bilateral aid because of less influence of political factors

CONCLUSION

Conclusion

- Aid is provided by bilateral and multilateral donors
- Global aid peaked in 1991 then declined in real and nominal terms until 1997, and rebounded thereafter
- In 2015, global aid reached about $150 billion
- There are three broad views on aid and economic growth

Summary

- **First: aid supports growth and development** by adding to investments and capital stock and in transferring technology from high income to lower income countries
- **Second: aid has no impact on economic growth** and stifles private sector participation, induces inflation and creating aid dependency

Summary

- **Third: aid works under some conditions and not under others**, depending on institutional and policy environment of the recipient country

THANK YOU!

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