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Effectiveness of Foreign Aid: A Critical Assessment [1]

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***Abstract**:* The studies on effectiveness of foreign aid have come through three generations and contain many arguments. Some experts charge that aid has enlarged government bureaucracies, perpetuated bad governments, enriched the elite in poor countries, or just been wasted. Others argue that although aid has sometimes failed, it has supported poverty reduction and growth in some countries and prevented worse performance in others. This paper explores the main arguments of the effectiveness of foreign aid and expounds the relationship between aid, growth and development. The findings of this paper reveal that the aid and growth during the last decade has found a positive relationship, in contrast to popular perceptions, particularly studies that have allowed for diminishing returns and have controlled for other factors that affect growth. However, it should be noted some studies have found that the aid-growth relationship is conditional on the policy or institutional environment, but many of those results have been fragile.

Keywords: Foreign aid, Political economy, Economic growth, Economic development.
JEL classification: F35; P16; O2, O16

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1.0 Introduction

Radelet (2006) argues that the ccontroversies about aid effectiveness go back decades. Critics such as Milton Friedman, Peter Bauer, and William Easterly have revealed stinging critiques, charging that aid has enlarged government bureaucracies, perpetuated bad governments, enriched the elite in poor countries, or just been wasted. They cite widespread poverty in Africa and South Asia despite three decades of aid, and point to countries that have received substantial aid yet have had disastrous records such as the Democratic Republic of the Congo, Haiti, Papua New Guinea, and Somalia. In their eyes, aid programs should be dramatically reformed, substantially curtailed, or eliminated altogether.

The term "Foreign Aid" is a broad one. The standard definition of foreign aid comes from the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), which defines foreign aid (or the equivalent term, foreign assistance) as financial flows, technical assistance, and commodities that are (1) designed to promote economic development and welfare as their main objective (thus excluding aid for military or other non-development purposes); and (2) are provided as either grants or subsidized loans. In general, it refers to any money or resources that are transferred from one country to another without expecting full repayment. International donors claim that they provide foreign aid to developing and transitional countries in order to assist these countries in raising the level of per capita income through economic growth, improvement of infrastructure and industry, strengthening of administrative capability, and so on. Scholars continue to debate why countries provide it: some argue that it is largely intended to support development in poor countries, and still others point out that aid has no affect on growth, and may actually undermine the economic growth. Therefore, the twentieth-century innovation, foreign aid has become a familiar and even expected element in development economics and international relations.

This paper examines the main arguments of the effectiveness of foreign aid, and expounds the relationship between aid, growth and development. To explore these arguments, paper is divided into following sections. Section 2 explains the meaning of foreign aid. Section 3 discusses who gives aid and who receives it. Section 4 ravels why donors give aid while Section 5 illustrates the schematic overview of the main development in the history of foreign aid. Section 6 discusses the relationship between aid, growth, and development. Finally, section 7 gives the summary and conclusion of this paper.

2.0 What is Foreign Aid?

Theories of international relations yield three basic answers to this simple question. According to political realism, foreign aid is a policy tool that originated in the Cold War to influence the political judgments of recipient countries in a bi-polar struggle (McKinlay and Mughan 1984). In liberal internationalism, it is a set of programmatic measures designed to enhance the socio-economic and political development of recipient countries (Opeskin 1996). On the other hand, according to world system theory, it is a means of constraining the development path of recipient countries and promoting the unequal accumulation of capital in the world (Wood 1986).

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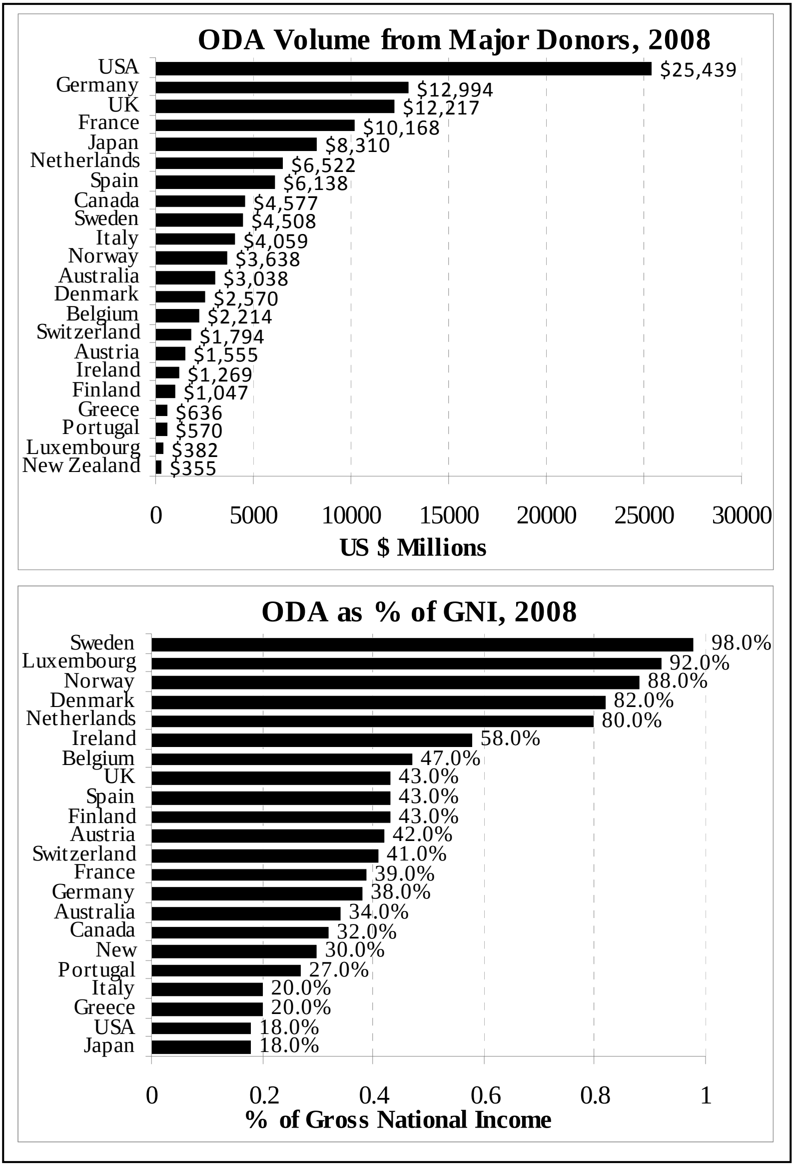
[4] http://www.oecd.org/home/0,3305,en_2649_201185_1_1_1_1_1,00.html

3.0 Who Gives Aid, and Who Receives It?

Historically most aid has been given as *bilateral assistance* directly from one country to another. Donors also provide aid indirectly through *multilateral assistance*, which pools resources together from many donors. The major multilateral institutions include the World Bank; the International Monetary Fund; the African, Asian, and Inter-American Development Banks, and various United Nations agencies such as the United Nations Development Programme.

Top foreign donor countries in 2008 are presented in Figure 1 and it shows the Official Development Assistance (ODA) volume from major donors in 2008. It demonstrates that United State is the main donor country to provide aid in terms of absolute term or total value. However, Radelet (2006) highlights that United States is a very smaller donor if aid is measured as a share of donor's income. In terms of total dollars, the United States provided $27.46 billion and Japan provided $13.10 billion in ODA. Thus, when aid is measured as a share of donor's income, the most generous donors are Sweden, Luxembourg, Norway, Denmark and Netherlands, and each of which provided between 0.82-0.98 percent of GDP in 2008. The United States is one of the smallest donors by this measure at about 0.18 percent of U.S. income in 2008.

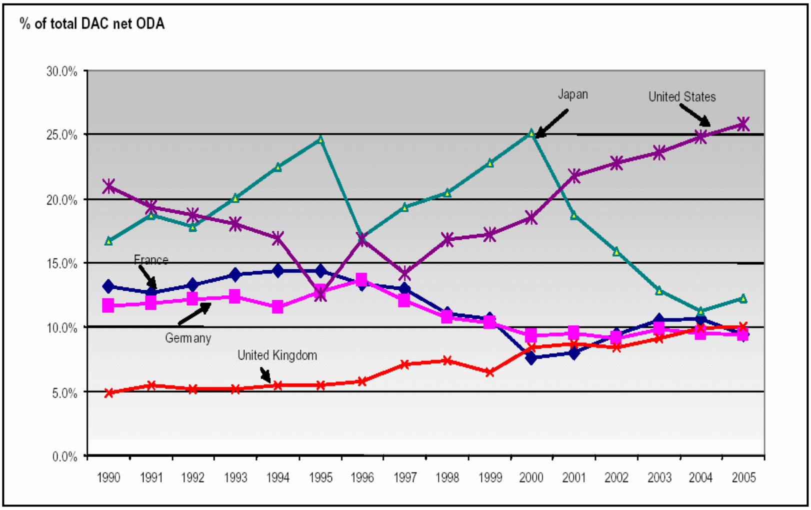
Figure 1: Top Foreign Aid Donor Countries in 2008.



Source: Based on OECD (2008).

Figure 2, shows the major ODA donor trends from 1990 to 2005. In general, two major donors have two different trends after 2000. United State has continuously increased the share of total net ODA. In contrast, Japan has decreased the share of total net.

Figure 2: Share of Total Net ODA by Major DAC Donor 1990-2007



Source: OECD (2007)

Moreover, literature emphasizes that 150 countries and territories around the world received aid in 2007. Table 1 shows the largest ten recipients, each of which received more than $1.8 billion. Iraq and Afghanistan together received over $13 billion. These amounts are unprecedented for two countries and account for about 15.4 percent of the global total. The amounts provided to other countries shown in the table are historically more typical for large recipients.

Table 1: Major Aid Recipients, 2007

	Total ODA (millions US$)		Aid as % of Recipient GNI		Aid per capita (US$)	
1	Iraq	9,115	Liberia	120	Wallis & Futuna	5,856
2	Afghanistan	3,951	Solomon Islands	67	St. Helena	4,329
3	Tanzania	2,811	Burundi	50	Montserrat	3,633
4	Viet Nam	2,497	Palestinian Adm. Areas	45	Nauru	2,556
5	Ethiopia	2,422	Micronesia, Fed.States	42	Mayotte	2,143
6	Pakistan	2,212	Guinea-Bissau	35	Tuvalu	1,174
7	Sudan	2,104	Afghanistan	34	Palau	1,117
8	Nigeria	2,042	Sierra Leone	33	Micronesia,Fed.States	1,044
9	Cameroon	1,933	Mozambique	26	Turks & Caicos Islands	770
10	Palestinian Adm. Areas	1,868	Marshall Islands	26	Marshall Islands	745

Source: OECD (2007)

There are three ways of measuring Aid: total dollars, as a share of GDP, or per capita. Each measure reveals different things. Total dollar amounts clearly are important but they do not tell the entire story. Aid measured as a share of GDP indicates its size relative to the entire economy, and is perhaps the most common measure. However, it can be misleading since a high ratio can be indicative of low GDP or a large amount of aid. The amount of aid needed to immunize 1 million children can look like a large share of GDP in a poor country and a small share of GDP in a richer country, when the amount per child might be roughly the same. On a per capita basis, the aid that flows to some of the largest recipients are fairly small. Palestinian received $1.8 billion in aid in 2007, but this was equivalent to just 2 percent of its GDP or about $9 per Palestinian. By contrast, Nicaragua received a slightly smaller amount, $0.8 billion in 2007, but for its 5.6 million people this was equivalent to about $149 dollars per person. For small countries, a little bit goes a long way. Tiny Sao Tome and Principe received just $36 million, but this translated into 67 percent of GDP and about $225 per person. Thus, it is important to look at all three measures of aid to get a clear picture.

4.0 Why Do Donors Give Aid?

Undoubtedly some aid is given with humanitarian motives in mind; however, according to the literature, most foreign aid is given for variety of political, strategic and economic reasons that benefit the donor countries in the longer term.

4.1 Political Reasons

Official Development Assistance (ODA) is often designed to achieve political objectives rather than increase the prosperity of recipient countries. In the United States, national security considerations often influence foreign-aid decisions. During the 1980s, Cold War considerations caused a sharp escalation in U.S. aid to Central America and the Caribbean even, as aid to Africa declined. More recently, concern over Middle East instability has made Israel, Egypt, and Jordan the largest recipients of U.S. foreign aid. Other donors have their own objectives. For many years Sweden targeted aid toward 'progressive' societies. In France, governments have sought to promote the maintenance and spread of French culture and the French language as well as the preservation of French influence. In Japan, aid has historically flowed disproportionately to neighboring Asian nations in which Japan has the greatest commercial interests, and has often been tied to purchases of Japanese products.

Donors have a variety of motives for providing aid, however, only some of those are directly related to economic development. There is little question that foreign policy and political relationships are the most important determinants of aid flows. During the Cold War, both the United States and the Soviet Union used aid to vie for the support of developing countries with little regard as to whether that aid was actually used to support development. The two largest recipients of U.S. foreign aid (including both OA and ODA) from 1980 until very recently were Israel and Egypt; as the U.S. provided financial support to back the 1979 Camp David peace agreement. Beginning in 2002 Iraq became the largest aid recipient in the world, and its reconstruction is likely to be among the largest single foreign aid programmes ever recorded. Taiwan and China have used aid (among other policy tools) to try to gain support and recognition for their governments from countries around the world. Many donors provide significant aid to their former colonies as a means of retaining some political influence (Alesina and Dollar 2000).

4.2 Economic Reasons

Filling the gaps

Providing aid to Less Developed Countries (LDCs) ensures that the savings gap and the foreign exchange gap are filled. For domestic investment to take place, domestic savings must also occur. If these are absent, then a flow of development assistance can help finance investment projects. Likewise, there should also be technical assistance to ensure that the capital is efficiently used. For some economists, development is synonymous with the creation of a sizable, modern manufacturing sector, as opposed to reliance on exports of primary products. The international product life cycle theory suggests that as countries industrialize they off-load more labour-intensive industries to countries in earlier stages of industrialization. This theory provides some support for the notion that the development of manufacturing industries frequently accompanies increasing prosperity in the developing world. However, others argue that aid for capital investment can be anti-developmental as more capital intensive production in countries may contribute to increasing levels of unemployed and consequential poverty.

An inflow of foreign exchange may also enable LDCs to import foreign capital considered necessary for economic growth and development. In the case of Zambia, where there have been considerable shortages of foreign exchange earning due to falling commodity prices and debt servicing, inflows of foreign exchange through aid have enabled the capital investment needed to maintain the copper industry. It should also be mentioned however, that debt relief would be more effective than aid in reducing the foreign exchange gap.

Self Interest of Donor Countries

Less and less development assistance is given in the form of outright grants and increased interest is being charged notwithstanding concessionary rates. Tied aid is also becoming more prevalent. Tied aid occurs where conditions are placed by the donor upon the recipient about what they use the aid assistance for. Usually, the recipients are required to purchase the exports of the donors. This may be a more expensive option than purchasing the capital from sources other than the donors. Tied aid may help fill savings and foreign exchange gaps; however, it may not always be in the best interests of the recipient country.

5.0 Schematic Overview in the History of Foreign Aid

The origin of modern foreign aid was launched in the aftermath of the Second World War. Table 2.1 shows the schematic overview of main developments in the history of foreign aid which is based on Hjertholm and White (2000) and Kamiljon T. Akramov (2006). According to the literature in 1940s, the main objective of foreign aid was reconstruction of war- ravaged Europe. In 1950s and 1960s donors mainly focused on the community development movements, productive sector (e.g. support to the green revolution) and infrastructure. In the 1970s, foreign aid focused on poverty and “basic human needs”, such as health and education. In 1980s the focus of international aid shifted to macroeconomic reforms and market liberalization. Both multilateral and bilateral donors focused on broad-based economic growth, trade, financial systems, and the promotion of market-based principles to restructure macroeconomic policies in developing countries.

Table 2: Schematic overview of main developments in the history of foreign aid

Decade	Dominant or rising institutions	Donor ideology	Donor focus	Types of aid
1940s	Marshal Plan and UN system (including World Bank)	Planning	Reconstruction	Marshall Plan was largely programme aid
1950s	USA, with Soviet Union gaining importance from mid 1950s	Anticommunist, but with role for the state	Community Development Movement	Food aid and projects
1960s	Establishment of bilateral programmes and regional development banks (including ADB and IDB)	As in the 1950s, with support for state in productive sectors	Productive sectors (e.g. support to the green revolution) and infrastructure	Bilateral donors gave technical assistance and budget support; multilateral donors gave project aid
1970s	Expansion of multilateral donors (especially World Bank, IMF and Arab-funded agencies)	Continued support for state activities in productive sectors and meeting basic needs	Poverty, taken as agriculture and basic needs (such as health and education)	Fall in food aid and start of import support
1980s	"Washington Consensus" and rise of NGOs from mid-1980s	Market-based adjustment (rolling back the state)	Macroeconomic reform and liberalization	Financial and structural adjustment aid and debt relief
1990s	Eastern Europe and FSU become recipients rather than donors; emergence of corresponding institutions (EBRD)	Move back to the state toward end of the decade	Support to political and economic transition, poverty and governance	Move toward sector support at the end of the decade
2000s	Bilateral aid agencies expanded aid flows (especially USA, establishment of MCC) and surge in private aid (remittances)	Move toward performance based aid allocation	MDGs, global health (HIV/AIDs), security and governance	Continued sector support with special focus on social sector

Source: Based on Hjertholm and White (2000); Kamiljon and Akramov (2006).

In 1990s donors focused on supporting political and economic transition, poverty and governance. However, in 2000s, the donor ideology of providing foreign aid has moved towards performance based aid allocation. For that, donors mainly focus on the MDGs, global health (HIV/AIDs), security and governance in the recipient country, and the type of aid is mainly decided by the social sector.

6.0 Effectiveness of Aid, Growth, and Development

Studies on aid effectiveness have gone through three generations. The first generation essentially spans 1970–72 and mainly investigates the aid savings link. Influenced by the Harrod-Domar model, in which savings is the binding constraint on growth, aid-induced saving is assumed to lead directly to investment and then to a growth through a fixed incremental capital-output ratio. The second generation runs from the early 1970s to the early 1990s and directly investigates whether aid affects investment and growth. The third generation, which began with Peter (1994) and continues to this day, has brought several innovations.

According to Radelet (2006), most foreign aid is designed to meet one or more of four broad economic and development objectives:

1) To stimulate economic growth through building infrastructure, supporting productive sectors such as agriculture, or bringing new ideas and technologies,

2) To strengthen education, health, environmental, or political systems,

3) To support subsistence consumption of food and other commodities, especially during relief operations or humanitarian crises, or

4) To help stabilize an economy following economic shocks.

Although policy makers have discussed these broader objectives for aid, economic growth has always been the main criterion used to measure the effectiveness of aid. However, there is no clear-cut relationship between aid and growth. Some countries that have received large amounts of aid have experienced high economic growth, while others have shown slow or negative growth. Concurrently, some countries that have received very little aid have done very well, while others have not (Radelet 2006).

What does the absence of a simple relationship mean? For some observers, it is an evidence of a failure of aid to achieve its basic objectives. However, for some analysts this simple correlation is misleading since, according to them, other factors affect both aid and growth. Some countries that have received large amounts of aid may face endemic disease or poor geography, or may be emerging from a long-standing civil conflict, in which case, aid might have a positive impact on growth even if the overall growth performance remains weak. Or, the causality could run in the opposite direction: donors give more aid to countries with slow growth rates, and much less to rapid growers like China. These analysts suggest that once the said other factors are taken into consideration, a positive relationship emerges. Still others conclude that aid works well under certain circumstances, but fails in others. Aid might help spur growth in countries with reasonably good economic policies, but might fail to do so where corruption is rife and the economy is badly mismanaged. According to this view, while the overall trend line is important, the variance around the trend and the reasons for that variance are also critical in understanding the true underlying relationships.

Debate on these issues has been ongoing for many years, and continues to date. However, there is general agreement on some broad issues. Even aid pessimists (at least most of them) agree that aid has been successful in some countries (such as in Botswana or Indonesia, or more recently in Mozambique and Tanzania), that aid has helped to improve health by supplying essential medicines, and that aid is an important vehicle in providing emergency relief following natural disasters. Similarly, aid optimists concede that much aid has been wasted or stolen, such as by the Marcos regime in the Philippines and the Duvalier regime in Haiti, and that even under the best circumstances aid can have adverse incentives on economic activity. Debate continues on the overall general trends, the conditions under which aid works or does not work, and on what steps can be taken to make aid more effective. Empirical evidence is mixed, with different studies reaching different conclusions depending on the time frame, countries involved, and assumptions underlying the research. Three broad views have emerged on the relationship between aid and growth.[5]

6.1 Optimistic-Positive relationship

Aid has a positive relationship with growth on average across countries (although not in every country), but with diminishing returns as the volume of aid increases. According to Radelet (2006), there are three key channels through which aid might spur growth:

1) The classic view is that aid augments saving, finances investment, and adds to the capital stock. In this view, poor countries are unable to generate sufficient amounts of saving to finance the investment necessary to initiate growth or enough for very slow growth at its best. In the strongest version of this view, the poorest countries may be stuck in a poverty trap in which their income is too low to generate the saving necessary to initiate the process of sustained growth (Jeffrey, et al, 2004). A related argument is that aid might help relax a foreign exchange constraint in countries that earn relatively little foreign exchange, a view that was popularized through the early “two-gap” models of economic growth.

2) Aid might increase worker productivity through investments in health and education.

3) Aid could provide a conduit for the transfer of technology or knowledge from rich countries to poor countries by paying for capital goods imports, through technical assistance, or

[5] This summary draws heavily from the review in Clemens et al. (2004).

through direct transfer of technologies such as the introduction of new seeds and fertilizers in the Green Revolution.

Aid also could have a positive impact on development outcomes other than growth, such as health, education, or the environment. Perhaps the best documented area is health, where aid supported programs have contributed to the eradication of small pox, the near-eradication of polio, control of river blindness and other diseases, the spread of oral rehydration tablets to combat diarrhea, and the dramatic increase in immunization rates in developing countries since 1970 (Ruth 2004).

6.2 Pessimistic-No affect on growth

In contrast, Mosley (1980); Mosley et al. (1987); Singh, (1985); Peter (1994) and Rajan and Subramanian (2005) show, aid has no affect on growth, and may actually undermine it. Many later empirical studies even iterated the lack of a relationship between aid and growth. At present, despite the fact that foreign aid accumulates significant means and that it has been practiced for decades, there is a growing attitude among researchers that aid has no tangible, long-term impact on economic development. In conveying this result, Dollar and Svensson (1997) are more restrained while others (Lal 1996; Lal 2005; Martens et al. 2002; Easterly 2006; Djankov et al. 2006) are very outspoken.

Facts are the driving force behind this change of attitude. Easterly (2003) led a larger research using data from 88 countries supported by the World Bank and found that aid had some positive visible influence on growth in just six cases. More specific in its conclusion was the single largest donor – the U.S. –when it concluded the following, after reviewing its long history as a donor: “The U.S. has granted $ 144bn in inflation-adjusted dollars to 97 countries in the period 1980-2000. These 97 countries had a median inflation-adjusted per capita GDP of $1,076 in 1980 but only $ 994 in 2000, a decline in real terms” Schaefer (2002).

Djankov et al. (2006) go a step further and state that aid has a negative impact on recipients. They highlighted that foreign aid causes a harmful impact on the democratic stance of developing countries and on economic growth by reducing investment and increasing government corruption. All these studies are based on large samples; and all state that there is no long-term positive influence of foreign aid on growth and the standard of living.

However, while each of these studies have suggested a variety of reasons as to why aid might not support growth: they have all highlighted five key points as to why aid might not be conducive to growth.

1) Aid could simply be wasted, such as on limousines or presidential palaces; or it could encourage corruption, not just in aid programmes but more broadly.

2) It can help keep bad governments in power, thus helping to perpetuate poor economic policies and postpone reform. Some argue that aid provided to countries in the midst of war might inadvertently help finance and perpetuate the conflict, and add to instability.

3) Countries may have limited absorptive capacity to use aid flows effectively if they have relatively few skilled workers, weak infrastructure or constrained delivery systems. (Aid could help redress these weaknesses, but it might not be its aim). Consequently, limited absorptive capacity in the recipient country reduces the effectiveness of aid.

4) Aid flows can reduce domestic saving and both private saving (through its impact on interest rates) and government saving (though its impact on government revenue).

5) Aid flows could undermine private sector incentives for investment or improvement of productivity. They can cause the currency to appreciate, thereby undermining the profitability of the production of all tradable goods (known

as the Dutch disease). Food aid, if not managed appropriately, can reduce farm prices and hurt farmer income.

Using the theoretical and empirical evidence mentioned above, studies have illustrated how development assistance leads to distortion and disruption of the domestic economy.

6.3 Moderate-Conditional relationships

The moderate viewers of foreign aid argue that aid has a conditional relationship with growth, helping to improve it under certain conditions. This view holds that aid supports growth in some circumstances but not in others, and searches for key characteristics associated with the difference. This conditional strand of the literature has three subcategories, with the effectiveness of aid depending on the characteristics of the recipient country, the practices and procedures of the donors, or the type of activity that the aid supports.

Recipient country characteristics: Based on the studies[6] which illustrate that aid stimulates growth in countries with several factors. They highlight several factors such as good policies, different country characteristics that might affect the aid-growth relationship, including export price shocks, climatic shocks, the terms of trade, macroeconomic and trade policies, institutional quality, warfare, type of government, and location in the tropics. All of these studies rely on an interaction term between aid and the variable in question, and many of the interaction terms are fragile.

Donor practices: Many analysts have argued that donor practices strongly influence the effectiveness of the aid. For example, multilateral aid might be more effective than bilateral aid, and "untied" aid is thought to have higher returns than "tied" aid, as

[6] For example Isham et al (1995); Alesina and Dollar (2000); Coolier et al. (2002); Burnside and Dollar (2000); Dalgaard et al. (2000); Dalgaard, and Tarp (2004)

discussed previously. Many observers argue that donors that have large bureaucracies, do not coordinate with other donors, or have poor monitoring and evaluation systems; undermine the effectiveness of their own programs.

Type of aid: According to Clemens et al. (2004) different kinds of aid might affect growth in different ways. They disaggregated aid into types most likely and least likely to affect growth within a few years (if at all) and separated it into three categories:

1) Emergency and humanitarian aid (likely to be negatively associated with growth, since aids tends to increase sharply at the same time growth falls following an economic shock)

2) Aid that might only affect growth after a long period of time, so the relationship may be difficult to detect (such as aid for health, education, the environment, and to support democracy)

3) Aid that is directly aimed at affecting growth (building roads, ports, and electricity generators, or supporting agriculture). A strong positive relationship is found between the third type of aid (about half of all aid) and growth, and results stood up to a wide variety of robustness checks.

Quibria, M.G., et al, (2005) shows that aid is effective when it is moderate in volume but becomes ineffective when the size of the aid program exceeds a critical value set by the absorptive capacity of the country concerned. They state that the effectiveness of aid in reducing poverty is not contingent on the macro policy environment. The result of their study suggests that effectiveness of aid does not hinge on the level of quality of governance. However, wiith respect to the impact of macroeconomic policy on poverty reduction, the paper offers mixed results. The study has found that aid has been more effective in the East Asia and the Pacific (EAP) compared to in other regions.

On the other hand, Prokopijevic (2007) answering the above questions point out that foreign aid fails because the structure of its incentives resembles that of central planning. He adds further that foreign aid is not ineffective due to that reason alone.. Instead of inspiring development and alleviating poverty, as it was repeatedly pointed out, foreign aid helps to preserve the poor state of affairs and entrenches power in those responsible for the poor conditions. It is also causes damage by preserving poverty, strengthening the state and stimulating corruption.

Moreover, Prokopijevic (2007) states that proposals to reform foreign aid – like aid privatization and aid conditionality – do not change the existing structure of the incentives in aid delivery, and their implementation may just slightly improve aid efficacy. Larger improvement is not possible. For that reason, foreign aid will continue to be a waste of resources, probably serving some objectives different to those that are usually mentioned, like recipient's development, poverty reduction and pain relief.

However, ineffectiveness of aid does not mean that all development aid operations must fail. Some aid operations were, and are, successful or partly successful. This means that they have achieved their objectives and improved the situation. However, this does not prove the case for foreign development aid, because successful operations are not numerous. Under central planning some successful firms also existed due to different factors – like protection by the state, insufficient competition, limited supply of the good produced, etc. However, they were just a small fraction of the economy and unable to reverse the fate of the whole order.

Mesquita and Smith (2007) model focuses on foreign aid for policy deals. Their theory explains the antithesis of why many Third World people hate the United States and want to live there. They derive a theory to answer four questions, namely: (1) Who gives aid? (2) How do donors determine how much aid to give? (3) Who gets aid? and (4) How much aid does each recipient get? To answer the above questions, the study derives a theory and suggests that the United States is most likely to give aid to states with small winning coalitions and large selectorates. The theoretical predictions show that the United States is most likely to give aid to nations with small coalition political systems and low levels of government resources. This theory predicts that as the resources available to the leader in the recipient state increase, then aid becomes less likely, but should aid be given, then the amount of aid generally increases.

Moreover, that model offers important policy advice for those who wish to help the needy around the world. Receiving aid is most likely to improve the welfare of citizens in large coalition systems. In such systems, the majority of the additional resources are allocated to public goods, and the leader can retain only limited resources for his or her own discretionary projects. Aid given to such systems is likely to promote economic growth and enhance social welfare. U.S. reconstruction aid to Western Europe under the Marshall Plan is an example of such a success story. In contrast, aid resources in small coalition systems disproportionately end up in the hands of the leader and his or her associates in the form of private goods and thereby do little to promote growth and development.

Roodman (2007) is of the view that aid, probably, is not a fundamentally decisive factor for development i.e. not as important as domestic savings, inequality, or governance. Moreover, he points out that foreign assistance is not homogeneous: it consists of everything from food aid for famine-struck countries to technical advice on building judiciaries to loans for paving roads; also, much aid is poorly used—or, like venture capital, is like good bets gone bad;(the statistical noise tends to drown out the signal) and therefore, the stories of effectiveness of aid do not shine through clearly. He comments that perhaps researchers will yet unearth more robust answers to the fundamental questions of aid policy; or perhaps they have already hit the limits of cross-country empirics. He concludes: either way, robust, valid generalizations have not and will not come easily; despite decades of trying, cross-country growth empirics have yet to teach us much about whether and when aid works.

Chong et al. (2008) examine the factors affecting the support for foreign aid among voters in donor countries. A simple theoretical model, which considers an endogenous determination of official and private aid flows, relates individual income to aid support and also suggests that government efficiency is an important factor in this regard. The empirical analysis of individual attitudes, (based on the World Values Surveys), reveals that satisfaction with own government performance and individual relative income are positively related to the willingness to provide foreign aid. They found that aid is linked with inequality, corruption, political leaning, and taxes in donor countries, but has little relationship with the economic conditions in the receiving country. It is worth to emphasize that aid generosity is found to be mainly affected by own government's efficiency and less by the recipient one. Furthermore, using actual donor country data they found that aid is adversely affected by own government inefficiency.

7.0 Conclusion

The pessimistic literature on the effectiveness of foreign aid provides very little evidence regarding the impact on economic development. However, they revealed an unexpected outcome of foreign aid - it reduces the level of democracy of the recipient countries. In that context, it is difficult to make aid effective. The conditional principle does not seem to work because of the lack of credibility of the punishment. Some empirical studies showed that loans may help to induce some discipline and a more effective use of the fund since they have to be returned. Other sources of foreign funds, like remittances and private assistance, have proved to be quite effective in fostering growth and investment. The increasing access to the aid market of new participants and the potential conflict of the goals of donors contribute to the ineffectiveness of aid.[7] Therefore, increasing the responsibility of recipient countries by providing loans instead of grants in a credible policy environment, reducing the cost of remittance to developing countries, and improving the coordination of donors seem to be reasonable goals to improve the effectiveness of foreign aid in the future

[7] This idea comes for Djankov et al (2006)

The newest wave of reform efforts aims to solve some of the weaknesses of aid and the principal-agent problem through greater donor selectivity in choosing aid recipients, increased recipient participation in setting priorities and designing programs, streamlining aid bureaucracies, increasing donor coordination, and establishing clearer goals for aid and stronger monitoring and evaluation of aid-financed activities. These ideas have been very influential in designing aid programs in recent years, but there is no systematic evidence at this point as to whether these changes will lead to greater aid effectiveness.

When the aforesaid studies are considered as a whole, it becomes apparent that the effectiveness of foreign aid is debatable. Many of the recent literature have explored how different types of aid might have different impacts on growth and have suggested one key reason as to why the earlier research has reached mixed conclusions - aid has been less effective in spurring development than expected. It is also apparent that aid can keep bad governments in power for too long, and can undermine incentives for saving, tax collection, and private sector production.

However, ineffectiveness of aid does not mean that all development aid operations must fail. Some aid operations were, and are, successful or partly successful. This means that they have achieved their objectives and improved the situation successfully or partly. In conclusion it may be said that the efficiency of foreign aid is a debatable study and it appears that aid has been successful in some countries but not others. The overall trend is subject to debate, but most studies have found a positive relationship and some a less or negative relationship. Since, as the saying goes, “something is better than nothing”; possible measurers should be taken to make the aids more effective by looking at the lessons from the history and ensure that the programme preserves the best interests of both recipient and the donor.

Radelet, *et al*. (2006) argue most empirical research on aid and growth conducted during the last decade has found a positive relationship, in contrast to popular perceptions, particularly studies that have allowed for diminishing returns and have controlled for other factors that affect growth. Some studies have found that the aid-growth relationship is conditional on the policy or institutional environment, but many of those results have been fragile. Some studies have concluded that there is no relationship or even a negative one, but while influential these studies are few in number and tend to use restrictive assumptions. Recent research that has explored how different types of aid might have different impacts on growth has suggested one key reason why earlier research has reached mixed conclusions.

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