# A REVIEW OF FOREIGN AID EXIT STRATEGIES

by

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I declare that the above study is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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# ABSTRACT

Foreign aid as an economic policy was previously widely accepted as a way to assist least developed economies to achieve economic growth. Over the years, aid effectiveness has been questioned, whilst aid dependency has continued to rise. To assist in aid reduction, various economists have proposed aid exit strategies that countries could adopt to reduce aid dependency. However, the adoption of these strategies has been rather slow. The purpose of this study was to review and assess the current literature on the different proposed foreign aid exit strategies, in terms of their feasibility and ease of implementation, taking into account the current state of African economies. The analysis focused on the exit strategies recommended by Tandon (2008), Moyo (2009) and Fee (2012). The main finding of this study suggests that the aforementioned exit strategies are feasible, but not necessarily easy to implement, due to the limitations faced by many least developed countries.

**Key terms:**

Foreign aid effectiveness; Foreign aid dependency; Economic growth; Foreign aid exit strategies; Official development assistance; Aid reduction; Foreign aid exit feasibility; Poverty eradication; Sustainable development; South Africa; Botswana; India.

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**LIST OF ACROYNMS**

**AIDS** Acquired Immunodeficiency Syndrome
**CIDA** Canadian International Development Agency
**DAC** Development Assistance Committee
**DFID** Department for International Development
**EC** European Commission
**EU** European Union

| | |
|---|---|
| **ERP** | European Recovery Programme |
| **FDI** | Foreign Direct Investment |
| **GDP** | Gross Domestic Product |
| **GNI** | Gross National Income |
| **HIV** | Human Immunodeficiency Virus |
| **HIPC** | Heavily Indebted Poor Country |
| **IFI** | International Financial Institution |
| **ILO** | International Labour Organisation |
| **IMF** | International Monetary Fund |
| **LDC** | Least Developed Country |
| **LIC** | Low Income Country |
| **MDG** | Millennium Development Goal |
| **MDRI** | Multilateral Debt Relief Initiative |
| **NGO** | Non-governmental Organisation |
| **OA** | Official Assistance |
| **ODA** | Official Development Assistance |
| **OECD** | Organisation for Economic Corporation and Development |
| **SIDA** | Swedish International Development Agency |
| **SME** | Small Medium Enterprise |
| **UN** | United Nations |
| **UNICEF** | United Nations Children's Fund |
| **UNDP** | United Nations Development Programme |
| **USAID** | United States Agency for International Development |
| **WGI** | Worldwide Governance Index |

# CHAPTER 1

# INTRODUCTION AND OVERVIEW OF STUDY

## 1.1 Introduction

Paul Kagame, President of Rwanda is of the view that foreign aid crippled self-reliance and defiled the dignity of his citizens (Lumu, 2016). Moyo (2009) argued that the main reason why only the continent of Africa has been locked in a cycle of economic dysfunction for many years is because of over-reliance on foreign aid. Furthermore, empirical studies have found that aid has had no impact on economic development or any poverty indicators (Boone, 1996; Svensson, 1999 and 2000; Knack, 2001; Brumm, 2003; Ovaska, 2003; Easterly et al., 2004; Djankov et al., 2008; Williamson, 2008). Despite this evidence and numerous calls to end foreign aid, aid has continued to flow into developing countries. For example, the Organisation of Economic Corporation and Development (OECD) reported that foreign aid increased by 4 per cent in real terms in 2017, with aid to sub-Saharan Africa rising by 3 per cent and humanitarian aid rising by 6.1 per cent (OECD, 2018). The OECD believes that this is still not enough and urges more donors to honor their 0.7 per cent target for official development assistance (ODA) (OECD, 2018).

In an effort to ease over-dependency on foreign aid, various economists have developed strategies on how these countries could reduce their dependency on foreign aid, including the work of Tandon (2008), Moyo (2009) and Fee (2012). Despite the availability of these exit strategies, OECD (2018) have reported that aid levels are now on the increase again, indicating slow adoption or non-adoption of these exit strategies.

The purpose of this study therefore was to review and assess the current literature on the different proposed foreign aid exit strategies, and to investigate their feasibility and ease of implementation, taking into account the current state of African economies. The analysis focused on the exit strategies recommended by Tandon (2008), Moyo (2009) and Fee (2012). In addition, the study conducted a country case review of countries that had successfully reduced foreign aid, these being, South Africa, Botswana and India extrapolating lessons learned from these donor evaluations report.

The main finding coming out of this study suggests that the exit strategies are feasible, but not necessarily easy to implement, due to the limitations faced by many least developed countries (LDCs). Furthermore, the findings from the analysis suggests that one of the contributing factors to aid dependency is the African mind-set, a mind-set of not believing in themselves that they are able to manage without aid. Therefore, for aid dependency to decrease in Africa, a change in the African mind-set is imperative. It has to start with the liberation of the minds of the people themselves, as that is where the main obstacle is experienced (Steve Biko cited by Brand South Africa, 2012). This finding aligns with one of Tandon's exit strategy of mind-set adjustment (Tandon, 2008). As Easterly (2006) and Moyo (2009) stated, outsiders cannot build a nation and that development should be led by the people themselves. Peter Bauer (1974) pointed out that what limits most poor countries is the citizens themselves and their governments (cited in Schleifer, 2009). It is, therefore, important to understand that a change in the people's mind-set is the key to exiting foreign aid.

This chapter aims to give an introduction and further information to the study. The chapter also outlines the research methodology, scope, limitations, justifications and structure of the study. Section 1.2 highlights the theoretical background to aid and the call to end foreign aid. Section 1.3 outlines the problem statement while section 1.4 discusses the aims and objectives of the study. Section 1.5 provides the research questions. Section 1.6 outlines the justification and rationale of the study. Section 1.7 describes the methodology used. Section 1.3 outlines the scope and limitations of the study and Section 1.9 outlines the structure thereof.

## 1.2 Background information

The enactment and successes of the Marshall Plan brought hope and belief that foreign aid will eradicate poverty in least developed economies, just as it had helped rebuild Europe in just under five years (Fee, 2012). Termed official development assistance (ODA), foreign aid became an acceptable policy to finance development in LDCs, thereby closing the savings gap. Recently, aid has been defined as government aid that promotes and specifically targets the economic development and welfare of developing countries (OECD, 2018). Foreign aid is given directly (bilateral being from country to country) or indirectly (multilateral) through organisations like the World Bank and IMF (OECD, 2013).

Foreign aid was institutionalised in 1944 at the Bretton Woods Conference, but its conceptualisation started in the 19th century during the colonisation era (Moyo, 2009). The British Colonial Development Act of 1929 legislated the giving out grants that targeted infrastructure projects across poorer countries (Fee, 2012). This illustrates how foreign aid has transformed through various systems, from the colonial era in the 19th century to the present day of the Sustainable Development Goals (Moyo, 2009). Details outlining the different phases of foreign aid are discussed in Chapter 2.

Two types of theories underpinned and influenced the adoption of foreign aid as a policy. These were the growth theories and the ethical theories (Riddell, 2008). The ethical theories influenced or explained the reasoning behind donors' decisions to give; these theories include utilitarianism, theories of justice, the capabilities approach and the rights-based perspective, all of which are discussed in section 2.3 of the study (Riddell, 2008). The growth theories were based on the econometric belief that a positive relationship between economic growth and savings exists (Riddell, 2008). The growth theories theorists believed that the major drawback to economic growth was a lack of savings and that aid would fill in that savings gap as shown by the Harrod and Domar Model (1946); Solow and Swan (1956); the Big Push Theory of Rosenstein-Rodan (1943); the Lewis model (1954); Rostow's stages of economic growth (1960); the Two-Gap Theory of Chenery and Bruno (1962); and, recently, the growth theories of Paul Romer (1986) and Robert Lucas (1988). This led to over $2.3 trillion of dollars flowing into sub-Saharan Africa and other LDCs in the past 50 years, with sub-Saharan Africa receiving the bulk of it (Easterly, 2000).

The one major determinant of aid allocation was based on the donors' economic and political interests, for example, expansion of their markets (Akramov, 2012). In most cases, foreign aid targeted a few main economic factors (education, health and population), which then had a knock-on effect on economic growth (Riddell, 2008). Studies have also shown that for aid to be effective, there were certain prerequisites, namely, good institutions, policies, climatic conditions and democracy (Riddell, 2008). For example, Burnside and Dollar (2000) stated that aid was effective in governments that had strong institutions and policies, whilst Daalgard et al. (2004) found that aid worked in countries that had a good geographic location.

As the years went by, with poverty levels still on the rise, the question whether aid was effective or not dominated the development sector (Moyo, 2009). Two schools of thought emerged, those that believed aid was effective, but required organisational reforms and the

opposite that believed that aid was not good for LDCs and should end (Riddell, 2008). To this day, the question of whether aid is effective or not, is yet to be conclusively answered.

Popular economists like Sachs (2005 and 2006), Riddell (2008), Stiglitz (2002), Burnside and Dollar (2000), Hatemi and Irandoust (2005) and Abugre (2010) have supported the view that foreign aid will help reduce poverty. Gomanee et al. (2002) conducted a study that revealed that foreign aid that targeted investment had an impact on economic growth, and therefore the call to end aid is unwarranted. Similarly, Fayissa and El-Kaissy (1999) conducted a study of 80 countries and found that aid did assist LDCs by supplementing their savings. Daalgard et al. (2004) also conducted a study, which showed positive correlation between aid and economic growth in developing economies. Abugre (2010) stated that sharing is an inherent human behaviour practiced by humans and animals alike, therefore it is inhuman to watch someone dying of starvation and not help when you have the resources to do so. Therefore, aid should not be controversial. He further stated that targeted foreign aid has helped save millions of lives across Africa (Abugre, 2010). For example, millions of lives of children in Africa have been saved through targeted programmes of controlling measles and other vaccinations. Similarly, HIV/AIDS and malaria programmes have and still are helping to save lives (Abugre, 2010; Sachs, 2012). This belief that foreign aid could end poverty was further cemented in the Millennium Development Goals(MDG), which aimed to half extreme poverty by 2015 (United Nations Millennium Project, 2005). The MDGs, were redefined and now are called the Sustainable Development Goals post 2016. A big supporter of the Sustainable Development goals, Jeffrey Sachs believes that we can end extreme poverty in our lifetime (Sachs, 2005). Sachs (2014) further argued that with the right economic conditions, foreign aid is effective and therefore more aid should be given to those that need it.

In contrast, various studies have found no positive relationship between foreign aid and economic growth. These include studies by Mosley, et al. (1987), Boone (1996), Jensen & Paldam (2003), Svensson (1999 and 2000), Knack (2001), Brumm (2003), Ovaska (2003), Easterly et al. (2004), Djankov et al. (2006a), and Williamson (2008). Griffin (1970), through his study of 32 under-developed countries, found that aid led to a reduction in domestic savings disagreeing with the one fundamental purpose of foreign aid. Boone (1994) studied over 96 countries that received aid and found that aid did not contribute positively to the lives of the people, but merely increased consumption or the size of the government.

Further evidence suggests that tied aid, which is aid given under the condition that the recipient would procure products only from the donor themselves. In this, case aid benefited

the donor and not the recipient; for example, in the case of the United States, where 75 per cent of aid given to poor countries is spent on products from America (Easterly, 2006). Williamson (2008) further argued that food aid was used as a mechanism for donors to find a market in LDCs where they could dump their excessive agricultural products thereby keeping prices higher in their own countries. It has also been reported that, over the years, an estimated $105 billion has been given to the governments of corrupt leaders under the umbrella of foreign aid (Coyne and Ryan, 2009). Coyne and Ryan (2009) further stated that this money was used to keep these dictators in power, instead of helping citizens, as there is no accountability. A study conducted by Alberto and Weder (2002) found no evidence that less aid is given to corrupt leaders and that, in certain instances, more aid is given to corrupt governments. Radelet et al. (2004) also agreed with this finding that aid encouraged corruption and does not incentivise private sector to improve productivity.

Without a doubt foreign aid has assisted world poverty, with levels having fallen in the past 30 years, achieving one of the Millennium Development Goal of halving the world poverty in half by 2015 (Ramirez, 2018). However, the drop in poverty levels was not consistent for the majority of the countries and was driven mainly by two countries: India and China. India's poverty levels dropped from 54 per cent in the 1980s to 21 per cent in 2016, and China's poverty levels dropped from 88 per cent in the1980s to 2 per cent in 2016 (Ramirez, 2018). It is important to note though that both India and China had very low levels of foreign aid in their budgets to begin with indicating a possibility that there were other factors that may have contributed to the drop in their poverty levels (Ramirez, 2018). In contrast, in countries where aid is given the most have not had significant reduction in poverty. For example, in sub-Saharan Africa, poverty levels have only dropped from 54 per cent in 1990 to 41 per cent in 2013, a much smaller decline in comparison to India and China (Ramirez, 2018). This suggests that highly dependent economies reduce aid at a very slow pace or that there are other factors that affects or neutralises the effectiveness of aid (Ramirez, 2018). Tandon (2008), Moyo (2009) and Fee (2012) have urged LDCs to find other resources to fund their development agenda and to stop relying on foreign aid, as they belived that aid had failed to achieve its main objectives.

The quest to end aid has increased over the years, this now being driven from the donors perspective, namely, the United States of America (USA) and the United Kingdom (UK). The UK cabinet has called on its government to reduce foreign aid, as these funds could be diverted to more internal pressing issues (Farand, 2017). Similarly, the US government recently announced that it intends to cut aid to poor countries by over one-third in 2018 (Harris et al, 2017). Although the reasons given by the US government wanting to end aid

are wrong, Dichter (2017) agrees with them that aid should stop. Dichter (2017) acknowledges the good that foreign aid has achieved, but argues that there is no correlation between the amount of money spent with the few significant economic shifts seen thus far. He further stated that many of the promises of aid have come up empty and that if aid were to stop, there is a real chance that these poor countries would have the motivation to change their economies (Dichter, 2017).

More recently, the initial objective of foreign aid, that is, to provide savings to LDCs has been questioned, with evidence showing that LDCs have the necessary savings for their development activities and do not need aid (The Global Justice Now, 2017). If these savings were being managed properly, aid would not have been a requirement. In most cases, the reports show that the amount of aid flowing into Africa is rising; but other studies show the opposite, that more money is flowing out of Africa than is coming in (The Global Justice Now, 2017). The 2017 data from Global Justice Now shows that $192 billion is flowing out of Africa in the form of corporate profits, debt repayments and tax evasion, while only $30 billion in aid is coming into Africa (The Global Justice Now, 2017). They further argue that it is a myth and misleading to say that Africa needs more aid, when the continent has the required resources to reduce its poverty levels. For example, South Africa's mineral wealth was estimated at $2.5 trillion in 2017, the Democratic Republic of Congo's minerals was estimated at $24 trillion and Nigeria is Africa's largest oil producer (The Global Justice Now, 2017). Peter Bauer (1974) once argued that foreign aid is like taxing poor people in rich countries and passing it onto rich people in poor countries (cited in Schleifer, 2009). With evidence like this, the unanswered question is: Why are most LDCs still dependent on foreign aid?

Aid dependency is defined as the process by which continued provision of aid does not seem to be making any significant contribution towards sustainable economic development (Riddell, 2008). Baldwin (1980) has defined aid dependence as a state in which a government is unable to perform many of its core functions without foreign assistance, reliance on others and lack self-sustenance. Aid dependency brings with it a loss of policy autonomy, undermines government's accountability to its citizens, and leads to government's failure in budgeting and transparency (Action Aid, 2011). To end this vicious cycle of aid dependency, various solutions, have been proposed on how LDCs can reduce their dependency on foreign aid. Kwemo (2017) suggests that LDCs should prioritise job creation, regional integration and economic engagement to reduce aid dependency. Tandon (2008), Moyo (2009) and Fee (2012) have gone further and recommended strategies on how LDCs may reduce their dependency on foreign aid. The main message coming from these

three authors is that foreign aid has failed to deliver what it had promised and that LDCs should start looking for alternative sources of funding for their development agenda, instead of getting themselves into more debt and fuelling corruption. Tandon's (2008) strategies involved the following seven steps: adjusting the mind-set; budgeting for the poor, not for the donors; making employment and decent wages a priority; creating the domestic market and owning domestic resources; plugging the resource gap; creating institutions for investing national savings; and limiting aid to national democratic priorities. Moyo's (2009) proposed strategies involved the following: involvement in the bond market, free trade, foreign direct investment and tax reformation (less taxing of remittances) and the development of micro-finance institutions. Fee's (2012) exit strategies consisted of the following: institutional development, domestic resource mobilisation, economic diversification, increased global funds and lastly self-help aid (Fee, 2012).

In addition to these exit strategies there are lessons and solutions from countries that have managed to reduce aid like Botswana, South Africa and India that other LDCs could learn from. In 1966, foreign aid contributed almost 60 per cent to Botswana's budget, but by 1978 it had dropped to 18 per cent and then to 0.4 per cent by the end of the 1990s (Fee, 2012; Kerapeletswe et al., 2008). A similar success story emanates from India, a country that was the world's largest recipient of aid from about $55 billion in 1992: aid was down to $1.14 billion in 2002 (Kamath, 1992; De Groot et al., 2008). Despite the availability of these exit strategies and approaches coupled with lessons from other countries on how to reduce foreign aid the majority of LDCs are still dependent on it and aid continues to rise. The ODA recipient list still shows 146 countries were still receiving foreign aid in 2017 (OECD, 2017). Furthermore, aid rose by 8.9 per cent in 2017 (OECD, 2017).

## 1.3 Problem statement

Various empirical studies have been conducted on the effectiveness of foreign aid or the impact foreign aid has had on economic growth, showing both the negative and positive effects of aid on economic growth. More questions have been raised as to why foreign aid is still on the rise if it has not been effective, calling for an end to aid from some economists (Easterly, 2006; Coyne et al, 2009; Radelet et al, 2004, Farand, 2017, and Dichter, 2017). This has led to extensive literature and proposals on how countries could reduce their dependency on foreign aid (for example: Kwemo (2017), Moyo (2009), Tandon (2008) and Fee (2012). The solutions on how to reduce foreign aid, in the form of the exit strategies have been proposed by various economists, like, Tandon (2008), Moyo (2009), and Fee

(2012). In addition, other donor organisations like the Swedish International Development Agency (SIDA), in their evaluation reports have outlined lessons learned from countries that have managed to reduce foreign aid over the years (Heldgear, 2008; Slob, 2008; Tjonneland et al., 2008; De Groot, 2008) . However, these provide high-level policy recommendations and not enough proven history nor detail on their success rate. As of now, there is no existing studies that have been conducted to assess the feasibility of the exit strategies being proposed by Tandon (2008), Moyo (2009) and Fee (2012).

Various reasons may be responsible as to why countries were not adopting these exit strategies, one of them may be that there is not enough literature on how this is to be achieved and the feasibility of these exit strategies. Feasibility reports or case studies conducted on countries that have implemented these policies would provide the much-needed guidelines on how to reduce foreign aid and giving them the much-needed Independence from donors. The problem is that very little literature exists on the feasibility of these exit strategies.

It was this gap in the foreign aid literature that led to the study and formed the basis of the problem statement of this study, which is stipulated as follows: Various literature exists on strategies about how to exit foreign aid, but there is a gap in the reviews, feasibility and ease of implementation. This lack of detailed information makes it difficult for LDCs to adopt the strategies. It is this fundamental problem that has led to this study, which is further explained in the section below under aims of the study.

## 1.4 Aims of the study

The purpose of this study therefore is to conduct a review and an assessment of the current literature of the different proposed aid exit strategies, and to investigate their feasibility and ease of implementation, taking into account the current state of African economies. To achieve the main objectives of this study and answer the research questions, the following sub objectives are outlined:

- Analyse historical background of foreign aid and its relationship to economic development;
- Examine the current state of aid;
- Analyse and review the proposed exit strategies in an effort to assess their feasibility and ease of implementation; and

- Conduct a country case study on countries that have successfully reduced foreign aid, so as to identify any key lessons that LDCs could adopt.

## 1.5 Research questions

To achieve the above objectives, the study aimed to answer the following research questions:

- What is the historical background to foreign aid and its relationship to economic growth?
- What is the current state of foreign aid?
- What are the current foreign aid exit strategies?
- Are these strategies feasible and easy to implement?
- What are the lessons to be learned from countries that have successfully reduced foreign aid?

## 1.6 Justification and rationale for the study

This study is important and justified for a number of reasons. Firstly, it will provide clarity on the latest debates on foreign aid effectiveness and the current state of aid flows. This will assist in assessing whether there is still a need to end foreign aid. Secondly, the study will provide literature on what the current foreign aid exit strategies are saying in terms of their feasibility and ease of implementation, to assist those countries that may want to implement such policies. Thirdly, it will provide guidelines on what policies may be implemented to reduce aid. This study will therefore contribute to the existing literature on aid exit strategies.

## 1.8 Research methodology

The main objective of the study was to conduct a literature review and an assessment of the different foreign aid exit strategies. The study was purely of a descriptive nature and no quantitative analysis was undertaken. Only secondary data was used to justify and support theoretical arguments. The main data sources were the three books on aid exit strategies, namely: Tandon's book, entitled Ending Aid Dependence; Moyo's book, entitled Dead Aid; and Derek Fee's book, titled How to Manage an Aid Exit Strategy. These three books formed the basis of the study because, as at the time of the research, they provided the most

comprehensive literature on foreign aid exit strategies. Other supporting literature used were the country case study reports successful aid reduction projects. The three chosen countries were India, South Africa and Botswana. The research material used for these case studies was the reports from the Donor Evaluation Reports commissioned by SIDA which outlined how the donors exited these countries and what were the lessons learned from them (Heldgear, 2008; Slob, 2008; Tjonneland et al., 2008; De Groot, 2008). Lastly, in order to provide theoretical background on foreign aid and the debates on its effectiveness, other literature was incorporated into the study from various sources. These were credible public sources from organisations like OECD, International Monetary Fund (IMF), and World Bank. Information from the general World Wide Web in the form of newspaper articles, blogs and comments from known economists was also used to provide further points of validation.

## 1.9 Scope and limitations of the study

The scope of the study was limited to the exit strategies by the three authors, namely Tandon (2008), Moyo (2009) and Fee (2012). The study did not assess the effectiveness of aid nor does it review whether aid is necessary or not; instead, it works on the assumption that most LDCs are at the point where they have made a decision to reduce their dependency on aid. Therefore, findings from this study would definitely benefit them. The study did not go into what each exit strategy entails, how it could be implemented, and the benefits thereof. Only a high-level definition of the exit strategies is given, as the theoretical background of each falls out of the scope of this study.

One of the main limitations of the study was the lack of any primary research on exit strategies. Therefore, there was no previous literature that had looked at the same topic, which could be used as a validation point. There are criticisms against the proposed strategies, but these are not based on any credible research and do not conclusively state whether these exit strategies are feasible or not.

## 1.10 Structure of the study

This study comprises of six chapters, that is:

- Chapter 1 introduces the study, outlining the research background, problem statement, research objectives and goals, justification and rationale for the study, the

research methodology, scope and limitations to the study and lastly how the study is outlined;

- Chapter 2 provides the theoretical concepts of foreign aid as a key element in international foreign policy, highlighting the transformation journey that foreign aid has undergone from the colonial era of the 19th century to the present day. It commences with the discussion on the definition of aid and the different types of aid. The chapter also looks at the determinants of aid allocation and the different ethical theories that shaped foreign aid with emphasis on the different growth models. The structure of the different organisations that forms part of the aid world was also covered;
- Chapter 3 details the theoretical review conducted of a number of key concepts and elements that have dominated the foreign aid discussions. The aim was to provide an understanding of the current state of foreign aid, as well as to provide the context needed to understand why there is a call to end foreign aid dependency. The factors included are: current foreign aid flows and trends as outlined by the OECD; a literature review of the different studies conducted on the impact of aid on economic growth; the different constraints that the foreign aid sector faces and lastly the criticism that have been levelled against foreign aid and the reforms being recommended to change the way aid works;
- Chapter 4 is the key chapter in the study, as it outlines the exit strategies under review. The chapter assesses the following four key areas of the exit strategies and the authors' work, namely: the main arguments from each author on why aid should end; criticism of foreign aid by each author; their recommendations or strategies for how LDCs could reduce foreign aid, essentially what policies countries could implement to reduce foreign aid. The differences and similarities between the three authors is also discussed and the chapter ends with the criticisms that have been made against the exit strategies;
- Chapter 5's main objective was to review the three countries that had successfully managed to reduce aid: Botswana, India and South Africa. To achieve this, the following country factors were examined: country background which looked at its population, economic status and their economic history. Their aid reduction strategy and management was then analysed focusing on their aid exit enablers and exit determinants. Furthermore, consequences of the aid exit decision were analysed, this essentially aimed to understand if any, what consequences were faced by these three countries as a result of the donors exit. Lastly, a comparative exercise between the exit strategies was conducted to identify any similarities, differences and if at all weaknesses; and

- Chapter 6 summarises the study by highlighting the main viewpoints identified in the study. A summary of the main findings of the study was outlined, policy recommendations that may assist LDCs raise alternative resources were also highlighted and finally the conclusion and recommendations for further research were discussed.

# CHAPTER 2

# CONTEXTUALIZATION OF ECONOMIC DEVELOPMENT AND FOREIGN AID

## 2.1 Introduction

Foreign aid is an important factor in many governments' budgets, from both the donor and the recipient's point of view. The importance of foreign aid continues to be illustrated, for example, by the British government who has recently passed legislation to honour their 0.7 per cent foreign aid target, whilst cutting their defence budget by 20 per cent (Anderson, 2015). This was again the case in 2010, when the British government cut its budget by 19 per cent, whilst development aid increased by 37 per cent (Peev, 2010). To enable us to understand why foreign aid is of such importance, a review of the history and theoretical frameworks behind it is warranted.

This chapter will therefore discuss the theoretical concepts of foreign aid as key element in international foreign policy. The chapter commences with a discussion of the definitions, the different types of aid, what is classified as aid and the exclusions pertaining to aid. It will also focus on how the different economic commentators define development assistance. Section 2.3 will look at the different determinants of foreign aid; which is key to understanding the different motives behind aid allocation, that is who gives aid to whom and why. This section will also briefly discuss the different ethical theories behind aid-giving, as narrated by Riddell (2008). Section 2.4 will analyse the need for foreign aid and the different economic drivers for foreign aid. Emphasis will be placed on the different growth theories that influenced the direction of foreign aid policy. Section 2.5 will focus on the transformation journey that foreign aid has undergone, starting for the colonial era of the 19th century to the present day of glamour aid, as Moyo (2009) terms it. Section 2.6 looks at how the aid world is structured and governed by briefly highlighting the different organisations and bodies that make up the foreign aid body, as well as a look at the current foreign aid levels. Section 2.7 will define what aid dependence means and the different indicators used to assess aid dependence. The chapter concludes with a brief summary of all the discussions provided in this chapter.

## 2.2 Definition of and types of foreign aid

The Centre for Global Development defines foreign aid, commonly referred to as official development assistance (ODA), as those flows, being cash, commodities or services given directly to countries (bilateral) or indirectly (multilateral) through development institutions like the World Bank and IMF for the intention of economic development and welfare (OECD, 2015). Hattori (2001) described the above definition as the idealistic definition and believes aid should be defined from three perspectives he outlined. Firstly, he defined aid from a political realism view, which defined aid as a policy tool that came out during the cold war to influence the political decisions of recipient countries in a bi-polar struggle (Morgenthau 1962; McKinlay and Mughan 1984; McKinlay and Little 1977,1978; Hook 1995 cited in Hattori 2001). Secondly, he called it the liberal internationalism definition which he states is a set of programmatic measures designed to influence the socio-economic and political development of recipient countries. The last one was based on what he called the world system theory where foreign aid is a means of hindering the development path of recipient countries and promoting the unequal accumulation of capital in the world. From the above definitions, clearly foreign aid is without its scepticism and critics. The criticism levelled against the definition of foreign aid will be discussed later in Chapter 3.

The Development Assistance Committee (DAC) of the OECD has classified aid into three main categories:

- Official Development Assistance (ODA) is aid provided to low and middle income countries;
- Official assistance (OA) aid provided to richer countries and to countries formerly of the Soviet Union; and
- Private voluntary or humanitarian aid, which consists of grants to non-government organisations (NGO), religious groups, charities and private companies.

The ODA definition excludes military aid, unless it is for humanitarian purposes, as well as debt relief and other non-developmental assistance. ODA is provided as either a grant or loan. Loans are concessional (that is below market interest) and have at least a 25 per cent grant element, whilst grants are viewed as a free resource that are used to replace government revenues. This study will primarily focus on ODA, as defined by the OECD, as it is this type of aid that has created a dependency from which most countries are trying to exit from. The terms foreign aid and ODA will be used inter-changeably throughout the study.

## 2.3 Determinants of foreign aid

This section aims to understand a few critical decisions that donors make before giving aid to developing economies. There are three main variables involved in aid and aid allocation, that is, who is giving aid to whom and why. Firstly, the criteria used to influences a donor's decision between cash transfers or in-kind transfers. Secondly, factors that influences a countries decision on which aid to pay bilateral or multilateral. Thirdly, whether former colonies, the poorest countries, strategic allies or others receive the largest piece of the pie. Various studies have been conducted to understand these variables, with the key question that they aimed to answer being: Is foreign aid motivated by self-interest or humanitarian concerns? The main finding in most studies does suggest one main reason, that donors are driven by both their own interests, as well as a desire to meet the needs of the recipient country (Akramov, 2012).

Below is a summary of the common determinants of aid that different studies have put forward:

- Recipients' needs: the needs of the recipient country seem to be important to most donors to making the decision on aid allocation. This was on the increase three decades before the war on terror, but seems to have declined after the events of 9/11 (Akramov, 2012);
- Donor's strategic and political interests: donors seem to give aid on the basis of political and strategic considerations at the cost of poverty reduction (Alesina and Dollar, 2000). This is also evidenced by Riddell (2008) who stated that the Japan's Ministry of Foreign affairs had once made a statement expressing their motive for giving aid which clearly stated that ODA is implemented to pursuit Japanese happiness and raise its citizen's profile;
- Donor's economic interests: donors allocate aid with the intention of expanding their markets, through inexpensive imports from developing nations and protecting the foreign investments of their private companies. It is believed that commercial interest plays a significant part than geopolitical interests (Akramov, 2012). For example, Riddell (2008) states that aid given by the USA is usually tied to the procurement of goods and services from the USA and that the transportation of these goods and services has to be in USA planes and ships. He further states that studies have shown that only 42 per cent of aid is untied;
- Population bias: some donors favour smaller countries, as they believe that aid will be much more effective in a relatively less populated country (Akramov, 2012).

- Differences between multilateral and bilateral donors : the multilateral focus is more on the recipient's needs, whilst the bilateral focus is more on own commercial needs (Akramov, 2012);
- Differences between bilateral donors : one sector of the donors, that is the Nordic countries of Denmark, Finland, Norway and Sweden, gave aid to countries with similar characteristics, that is, countries with less per capita income, open economies, and democratic governance. The larger donors such as France, Japan and the US, allocate aid to countries based on political alliances and/or to former colonies (Alesina and Dollar, 2000);
- The bandwagon effect : donors believed that the impact of their aid will be higher if other donors were to give greater amounts to a recipient country (Alesina and Dollar, 2000);
- Perceptions of recipients' governance: studies on Aid allocation based on good governance showed mixed results. The one sector found that aid is allocated to countries with good governance, good policy outcome (Dollar and Levin, 2004). The second one argues that donors allocate more aid to better governance only at a margin (Alesina and Dollar, 2000). The third one argues that a lot of foreign aid still goes to corrupt governments (Easterly, 2007); and
- Public support for aid: Riddell (2008) states that there is a link between the level of citizens or public support and the amounts the government provides. The stronger the level of public support, the higher will be the aid given. This is based on the David Lumsdaine's 40-year survey of aid-giving, which led him to believe that there is a positive relationship between aid giving and public support for it (Riddell, 2008). However, other studies have shown no correlation at all, for example McDonnell et al. (2003) in the case of Japan, where ODA rose by 50 per cent and yet public support fell sharply and Olsen (2001) when French aid to Africa fell at a time when public support was high (McDonnell et al, 2003; Olsen, 2001 cited in Riddell, 2008).

### 2.3.1 Ethical theories and approaches on aid giving

In an effort to further understand the determinants for aid giving, Riddell (2008) describes a number of theories that sheds light on donor's decision making. These are outlined below:

- Utilitarianism: it basically means that morally the main objective of life should be to continuously try to achieve maximum happiness and satisfaction for all. Therefore, greater overall satisfaction can be obtained by providing assistance to those whose

happiness and well-being are severely limited, as long as the reduction in happiness resulting from helping is less that the gain in happiness of those being helped;

- Theories of Justice: Rawls theory of justice argues that those individuals living behind the “veil of ignorance” would agree that liberty, opportunity, income and wealth should be distributed equally unless unequal distribution is to the advantage of the least favoured. In this case then, the state is to take resources from those that ‘have’ and give it to the ‘have nots’. In 2003, the world produced goods and services to the value of $36 trillion. Of this total, 80 per cent accrued to the 52 richest countries, in which 17 per cent of the world population resides. This indicates that the rich countries have the means to help the poor so therefore they should (Riddell, 2008);
- The capabilities approach: Amartya Sen’s capabilities approach to development states that for people to flourish they need certain basics and capabilities; for example, free access to basic education and health. It is therefore important that activities should be conducted to ensure that the reduction and eventually elimination of these basic capabilities and rights (Riddell, 2008);
- Rights based perspective: extreme poverty has been described by the UN as a violation of human dignity and denial of human rights. Therefore, the need to give is not an option, but rather a moral case: those who can should help those who are in need (Riddell, 2008); and
- Obligations based on responsibilities for perpetuating poverty and suffering: this view is based on the fact the former colonies bear some historical and moral responsibility for the current levels of poverty and under-development in former colonies, and therefore they have an obligation to help them (Riddell, 2008).

## 2.4 Economic growth theories and foreign aid

Over the decades various economic growth theories have emerged and shaped economic thinking on what variables are required to ensure sustainable economic growth. The importance of savings and investments has been stressed over centuries, as it has a direct impact on a country’s Gross Domestic Product (GDP) levels and a country’s ability to reach a certain level of economic growth. However, most developing economies lack the required level of savings to ensure a sustainable level of economic growth. These have resulted in development economists and governments viewing foreign aid as a way to overcome the scarcity of these variables vis a vis financial savings or investment. The early theorists were the classical theorists, that is: Adam Smith in 1776; David Ricardo in 1817; and Thomas Malthus in 1798. They were followed by the neo-classical theorists, whose theories

influenced the birth of foreign aid. The popular neoclassical theorists and theories include: the Harrod and Domar Models in 1946; Solow and Swan in 1956; the Big Push theory of Rosenstein-Rodan in 1943; the Lewis Model in 1954; Rostow's stages of economic growth in 1960; the Two-Gap theory of Chenery and Bruno in 1962; and, recently, the growth theories of Paul Romer (1986) and Robert Lucas (1988). In their different ways, they all argued that the main constraint to economic development is the lack of capital accumulation and domestic savings on the part of poor countries and that foreign aid therefore had a key role to play.

In this study, only the following growth theories, which are commonly used for foreign aid decision making will be reviewed briefly, namely: the Harrod and Domar growth model (1946); Rostow's stages of economic growth (1960); the Big Push theory of Rosenstein-Rodan (1943); the Two-Gap theory of Chenery and Bruno (1962).

### 2.4.1 The Harrod and Domar model (1946)

The Harrod and Domar growth model was developed by Sir Roy Harrod and Evsey Domar in 1946. The model is based on the general Keynesian principles of growth. Its main theoretical contribution is that a country's economic growth rate is dependent on the level of savings and the productivity of capital, labour productivity and level of technology. A brief production function is written as Y = f(K,L,N,S) (Marina, 2013)

The model suggests that there is a correlation between the rate of savings and productivity of the country's investments to economic growth. It implies that if a country invests a certain portion of their GDP and uses that investment more efficiently through technological advances it will result in a positive economic growth. The implication of this model is that most poor countries do not have the required savings to invest for economic growth hence the need for foreign aid (Hansen and Tarp, 2000).

### 2.4.2 Rostow's stages of economic growth (1960)

Rostow's Stages of Growth theory was developed by Walt Whitman Rostow in the 1960s. He postulates that for an economy to grow, it should pass through five stages of maturity. The first stage is the traditional society, which is a more organic type that is based on agriculture with little use of technology. The second stage is termed the Pre-conditions for Take-off, which is the start of a secondary sector characterised by demand for raw materials,

the production of goods and the use of technology. The third stage is the Take-off stage, in which the economy takes off. It is characterised by urbanisation, growth of industries and technological advances. The fourth stage is the Drive to Maturity stage, in which the economy is maturing and will have industries that are diversifying, infrastructure development, schools and transport. The fifth stage is the Age of High Mass Consumption. It is characterised by an industrial economy and less of a primary-based economy; consumption of luxury goods is at its peak and consumers have a disposable income. Again, Rostow's model suggests that economic growth depends on investments and capital accumulation. He states that capital formation is based on the productivity of agriculture which leads to growth of the export market earning much needed foreign exchange for the economies. Rostow therefore believed that foreign aid properly applied to third world countries or what we now refer to as less developed countries will transition their economies from an agricultural economy into an industrialised economy through the five stages described ( Rostow,1959).

### 2.4.3 Rosenstein-Rodan (1943 and 1961): The "Big Push" Theory

The originator of this theory was Paul Rosenstein-Rodan in 1943. The main idea behind this theory was that LDCs require large amounts of investments to be pushed onto a path of sustainable economic development. The theory further states that "bit by bit" investment in developing economies does not have the desired outcome, but rather leads to a waste of resources. The main component of this theory is that individual firms are not able to manage large investment initiatives therefore state or government agencies should step in to assist in the coordination of these initiatives (Easterly, 1997). The 1980s saw the "big push" idea resurface again, when the effectiveness of foreign aid was being questioned. Sachs (2005) argued that LDCs required large amounts of foreign aid and economic reforms to ensure a sustainable economic growth and to end extreme poverty by 2025. It was against this backdrop that the Millennium Development Goals (MGDs) were enacted. The MDGs were eight international development goals that were developed at the UN millennium summit in 2000. As a benchmark, the proponents of the big push theory argued that the idea had worked in Europe post second world war during the great depression, when Europe had massive financial injections to help it to rebuild itself and put it onto a path of sustainable development (Easterly, 1997).

### 2.4.4 Chenery and Strout: Two-Gap Theory (1966)

The Two-Gap theory of Chenery and Strout (1966) states that foreign aid is required to fill both the savings gap and a foreign exchange gap in poor countries, which they believed would have a positive effect on investment and higher aggregate growth (Riddell 2008; Easterly, 1997). The first gap is aimed at closing the domestic investment gap, which is required to attain a certain rate of growth; the second gap is the foreign exchange gap, which occurs when foreign exchange earnings are required for a country's production needs (Ndi, 2010). Chenery and Strout (1966) built on their work on the earlier work of other economists, namely Arthur Lewis (1954) and Rostow (1960)(Easterly, 1997). The Two-Gap theory also supports the theoretical hypothesis of Harrod-Domar model (1946), which assumes a certain rate of investment to increase growth rate. The Two-Gap theory is the standard model that was used as the basis to justify the need for foreign aid at any point in time, should a country have an investment or foreign exchange gap (Fee, 2012).

### 2.4.5 Summing up the link between economic growth theories and foreign aid

In the mid-1980s the new growth theories of Romer (1986) and Lucas (1988) emerged. They focused on the importance of human capital formation, technology, research and development which when efficiently used with the right levels of investments and savings may lead to increasing returns (Riddell, 2008).

It is interesting to note that, the foreign aid model has been transformed over the years and it has mirrored the growth theories above. As indicated by many development theorists, when implemented as aid policies, these theories have not resulted in sustainable growth for most economies, but rather in under-development (Ndi, 2010). Most of these early aid theoreticians argued that it is not enough to know which variables have a positive effect on growth and that there is no one-size-fits-all approach; each case must be considered separately and growth strategies that are appropriate for that country's economy should be applied (Riddell, 2008).

## 2.5 The transformation phases of foreign aid

Foreign aid, as a concept and policy, has evolved through a number of phases, from the early years of colonisation in the 19th century to the recent years of glamour aid of the 2000s. Lessons from these events indicate how financial aid is still believed to be the answer to the

woes of least developed economies to assist them onto a path of sustainable economic growth.

Outlined below is the transformation journey that foreign aid, as a policy, has gone through, highlighting only the key transition stages.

### 2.5.1 The Period 1900 – 1940: Initial stages of foreign aid

#### 2.5.1.1 Colonial expansions

The year 1944 is commonly known as the year that foreign aid was officially institutionalised as a development policy at the Bretton Woods Conference (Fee, 2012; Tandon, 2008). However, the concept of the richer countries providing assistance to the poor nations has been in existence since the early 19$^{th}$ century (Fee, 2012).

The nineteenth century saw the colonisation and expansion of European and British power throughout Africa and the entire world. (Fee, 2012; Ndi, 2010). The Colonial Development Act of 1929 entrenched the colonisation. Under this Act, the British government gave out grants targeting infrastructure projects across poorer countries (Moyo, 2009). During much of this period, it was voluntary associations often churches and church-based organisations and not rich countries governments, who were the main providers of key services to poor people in most poor countries (Moyo, 2009). The World Council of Churches states that between 40–60 per cent of health, education, water and food security services during that period were provided by the churches in Africa (Riddell, 2008). Bodies such as Christian Aid, the Cooperative for Assistance and Relief Everywhere (CARE), Catholic Relief Services, the Oxford Committee for Famine Relief and Save the Children, were up and running before any official bilateral donor agency had even been created. If the churches were already having an impact on poor countries, what role then did the western powers play with foreign aid? Easterly (2006). Moyo (2009) believed that aid transfer in these early periods was not about achieving the social requirements of the recipients, but rather about the donors wanting to maintain political control over them. It was only later, in the 1940s, with the British Colonial Development and Welfare Act that there was an element of aid for social activities (Moyo, 2009).

#### 2.5.1.2 The League of Nations and its agencies

Another significant development that shaped foreign aid in the 19$^{th}$ century was the covenant of the League of Nations. The year 1919 saw the establishment of the covenant of the League of Nations under Article 22 (Moyo, 2009). It came about due to the direct

consequence of the end of the 1st World War and the Treaty of Versailles. Its main aim was to maintain world peace which meant preventing wars through collective security and disarmament (Moyo, 2009). Other main issues that it was responsible for was ensuring good labour conditions under the agency called International Labour Organisation (ILO), just treatment of native inhabitants, prevent human and drug trafficking, global health and protection of minorities in Europe (Moyo, 2009). During the 1940s, the ILO argued and mobilised for aid funds to be provided to raise living standards in the poor countries. The League lasted for 26 years, after which it was replaced by the United Nations (UN) (Fee, 2012).

In 1943, the United Nationals Relief and Rehabilitation Administration was established, received funds from more than 40 countries in order to help it provide food, medicines and agricultural and industrial goods to recipient in almost 50 countries (Riddell, 2008). Furthermore, the UN charter of 1945 committed all countries involved to work to promote living standards, full employment and economic and social progress (Riddell, 2008).

#### 2.5.1.3 The Bretton woods system

The Bretton Woods System emerged in 1944, after the Second World War, when over 700 delegates from 44 countries met to design a framework that the global financial system could operate under (Moyo, 2009). The outcome of this meeting was the aid-based development emerged. They met in Mount Washington in Bretton Woods, New Hampshire. They established the rules that governed the commercial and financial operations among the world's major industrial countries (Moyo, 2009). The aim was to redesign the international finance, establish a multilateral trading system and construct a framework for economic cooperation that would avoid a repeat of the Great Depression of the 1930s (Moyo, 2009). Simply stated Europe needed funding to rebuild itself. Out of it was birthed the International Monetary Fund (IMF) and International bank for Reconstruction and Development (IBRD), which today is part of the World Bank. These organisations were at the pinnacle of that transition (Moyo, 2009).

#### 2.5.1.4 The Marshall Plan and Cold War Era

The year 1947 saw the development of The Marshall Plan, officially known as the European Recovery Program (ERP), led by the US Secretary of state George Marshall was developed in 1947 (Moyo, 2009). Its main aim was for American to provide financial aid to Europe to help it in rebuilding its economy after the devastation of the 2nd world war. The welfare principle enforced the Marshall plan (Fee, 2012). It was also aimed at preventing the spread of Soviet Communism. Over the course of those four years, $13 billion was spent. The

Marshall Plan established the Organisation for European Economic Cooperation, which later became the OECD to run the programme. The Marshall plan lasted for four years, as planned, and ended in 1951 (Fee, 2012). It was during this period that Europe recorded the fastest period of growth in history. Industrial production increased by 35 per cent (Fee, 2012). Besides turning around the European economy, it gave America the ability to influence foreign policy and won allies in western Europe. Key lesson from the Marshall Plan was that it promoted the view that investment capital is critical for economic growth (Fee, 2012). It was the success of the Marshall Plan and the lessons learned that were used to assist other parts of the world that were struggling with their economies especially Africa (Moyo, 2009). They believed that Africa was ready for aid due to factors such as uneducated population, high levels of unemployment, a non-existent tax base and poor infrastructure. So, armed with the lessons from the Marshall Plan foreign, aid began to flow into Africa (Moyo, 2009).

Moyo (2009) also states that another key reason why Britain and United States of America (USA) turned their attention to Africa was to maintain geopolitical holds. With colonialism lessening and many countries gaining their independence, aid became a means by which the western countries could maintain their strategic geopolitical holds. For the USA aid became a tool for the Cold War. The Cold War was termed as such, as there was no physical fighting between the two sides rather, it was an economic war. The two sides in the cold war were the two economic super powers: the United States and the United Soviet Socialist Republic (USSR). It was simply a move to change the world into following either a capitalist or a communist regime. The USSR and USA competed for influence in Latin America and decolonizing the states of Africa, the Middle East and South-east Asia. As a result, aid allocation was no longer about the country's economic needs, but more about political alignment (Moyo, 2009).

#### 2.5.1.5 The Truman Doctrine

President Harry S Truman's inaugural speech of 1949 cemented the USA stance and enhanced the Cold War. Commonly known as the Truman Doctrine, which stated that the USA would provide political, military and economic assistance to all democratic nations under threat from external or internal forces. His doctrine established the future direction of development aid and foreign policy from a USA perspective the USA became the world's policeman and donor (Fee, 2012).

## 2.5.2 The Period 1955–1970s: The Golden Age of Development Aid/Decade of Industrialisation

This phase was triggered by the decolonisation process of most African states. However, many of these African countries were not prepared for this transition, as they still required support from the developed world to run and manage their countries (Moyo, 2009). This made the need and support for aid stronger, leading to increase in aid flows. Broad guidelines on the uses of the funding were made and aid seemed to be working. These were termed the 'glory years for development aid', as Moyo (2009) called it.

This saw the establishment of a number of new multilateral aid institutions and bilateral aid programmes. In 1958, the European community launched the European Development Fund to assist the colonies with their development initiatives. Other agencies mushroomed United States Agency for International Development (USAID), Department for International Development (DFID) in 1961 and the Canadian International Development Agency (CIDA) was 1968 (Riddell, 2008).

The 1960's was proclaimed by the UN as the first development decade and a growth orientated strategy was developed that outlined a flow of capital to developing countries which aimed to reach a target of 1per cent of national income of all the industrialised nations. Overall aid flows between the years 1965 and 2010 rose from $5.8 billion to $90 billion, of which $1 billion to $30 billion went to African countries. Despite the increase in foreign aid, there was still not much infrastructure to speak of and GDP in Africa declined by 1.3 per cent (Moyo, 2009).

### 2.5.2.1 The 1970s – The poverty alleviation era

By the 1970s, the effectiveness of the growth-oriented strategy was slowly being questioned (Fee, 2012; Moyo, 2009; Tandon, 2008). It was widely believed in policy circles that it was failing in its mission to deliver sustainable economic growth. Countries were characterised by increases in levels of unemployment, people living in absolute poverty, high inequality and poor balance of trade status. This created a belief that sustained economic growth cannot occur unless the poorer countries' economies are improved and this demanded a new aid strategy (Sachs, 2005). Then the focus shifted to poverty eradication. The World Bank was now the world's largest aid donor and not the US anymore.

Two major organisations namely The World Bank and the ILO were at the forefront of the change in the aid strategy. Together they presented an approach to development based on the notion that poverty alleviation cannot be achieved through a focus on growth rates alone, but that it had to be dealt with directly (Riddell, 2008). The World Bank presented the redistribution growth strategy, which would focus on factors that would ensure wealth redistribution. The ILO introduced the basic needs approach to development, which focused on the basic needs of citizens, namely, water, food, housing, health and transport (Riddell, 2008).

With these new approaches introduced, aid flows were now a lot more focused on specific sectors and sub-sectors (education, health and water), which was aimed at impacting the people directly at the grassroots level (Riddell, 2008). As aid went into different projects, new technical skills were required to design, implement and monitor these projects. This resulted in donors bringing experts into these fields thus swelling the number of people involved in the business of providing aid (Riddell, 2008).

The 1970s also saw the growth of non-governmental organisations (NGO) involvement in foreign aid development. For example, the Peace Corp's budget rose from $860 million to $2.3 billion by the end of the decade. However, the change that aid was meant to bring to Africa's economy was invisible (Moyo, 2009).

In the late 1970s, The Partners in Development report was released, commissioned by the then President of the World Bank, Robert McNamara and headed by Lester Pearson (Riddell, 2008). The report recommended that rich countries should make a commitment to double aid levels within the space of the next five years. It called for official aid to reach the target of 0.7 per cent of GNI, but cautioned that an increase in aid should only be forthcoming if efforts were made to enhance the efficiency of aid (Riddell, 2008). The new aid targets were linked to efforts to expand trade and investment, and to addressing the growing debt problems of developing countries (Riddell, 2008).

Another key occurrence of the 1970s was the oil crisis of 1973, oil prices rose, which led to low real interest rates, rise in food and commodity price shocks. This led to many poorer nations borrowing to repay previous debt. Unless foreign aid was in the form of grants, it had to be paid back which left many African states in huge debts. Aid was redirected away from large infrastructure investment and towards projects in agriculture and rural development and social services a shift towards a poverty-based approach (Fee, 2012; Moyo, 2009; Riddell, 2008).

The late 1970s saw aid flows falling. Aggregate official aid had fallen to 0.33 per cent of GNI, compared with over 0.5 per cent at the start of 1960. ODA had come to a halt, the USA had already begun to reduce aid levels, linked in part to the escalating costs of the Vietnam War and other political attention on South–East Asia (Moyo, 2009).

### 2.5.3 The 1980s – The lost age of development

The year 1979 saw another oil crisis triggered by the Iran-Iraq war. This time the banks tightened their monetary policy by raising interest rates (Moyo, 2009). As interest rates were being raised, the cost of borrowing increased to levels where debt was simply unsustainable. Debt rose from $2 billion in 1975 to $8 billion in 1982 (Moyo, 2009). The world fell into high inflation and recession, which resulted in lower demand for developing countries' exports; this, in turn, resulted in lower foreign exchange earnings (Moyo, 2009). Most African countries defaulted on their debt, putting at risk the existence of the banks that relied on loan repayments for survival. To resolve the debt repayment problem the Structural Adjustment programme was enacted, with its main objective being to lend money to the defaulting countries to enable them repay their debt (Moyo, 2009). The structural adjustment programme only worsened the situation as countries went into more debt, with increased interest rates and declining demand for goods. This eroded all the achievements that foreign aid had supposedly achieved in the past twenty years. Amidst all this chaos, there was another fundamental shift in economic thinking emerging which focused on government led economic planning (Fee, 2012).

Government-led economic planning seemed to be working well in western governments, and as was the practice it was replicated and implemented in developing economies (Fee, 2012). However, this approach did not last long and by the 1980s government involvement was viewed as an obstacle to growth. The focus shifted to neo-liberal thinking, which argued that governments should liberalise their economies in favour of the laissez faire paradigm of promoting free markets, with Milton Friedman as the proponent (Moyo, 2009). The Asian tigers seemed to have achieved high growth rates and unprecedented poverty reduction with free-market policies and an outward orientation (Moyo, 2009). This led to these neo-liberal policies being recommended and implemented in Africa. Aid based programmes called Stabilisation and Structural Adjustment programmes were introduced. Stabilisation meant reducing a country's imbalances to reasonable levels, for example, the government fiscal position and the country's import–export ratio (Moyo, 2009). Structural adjustment was aimed at encouraging greater trade liberalisation and reducing price and structural rigidities

by such means as removing subsidies. This would entail reduction of state involvement, privatization of states assets, trade liberalisation and dramatically reducing the civil service, cutting private sector regulations and reducing direct taxes all to stimulate growth of the private sector. This led to a reduction of foreign aid flows towards poverty alleviation initiatives as aid now tilted in favour of stabilisation and structural adjustment packages as rallied at the Washington consensus. This resulted in a dramatic fall of ODA when all bilateral donors cut their aid budgets. The large number of conflicts happening in most parts of the continent did not help the situation either (Moyo, 2009).

The state of affairs propelled a second major international report on aid and development. The Independent Commission was set up to try to address the growing criticism on the effectiveness of aid (Riddell, 2008). The report entitled North-South: A Programme for Survival, and widely known as the Brandt Report, was published in 1980. Another was published in 1983, titled Common Crisis. A key concept underpinning the two Brandt reports was that of global interdependence, and the assertion that the rich world had to assist the poor and the disadvantaged, and that they would lose out if they did not help them (Riddell, 2008). The Brandt commission looked at poverty, hunger, disarmament, trade and energy. It came with an emergency programme which had aimed for large scale transfers of resources to developing countries. Brandt believed that aid remained vital and he called for doubling of ODA to reach a target of 0.7 per cent. Contrary to the report's recommendation ODA contracted (Riddell, 2008).

By the mid-1980s, aid levels began to rise again, because of the end of the severe economic crisis and the view that structural adjustment was not working and that more aid was needed (Riddell, 2008). This recommendation was contained in another World Bank report which proposed a doubling of aid for sub-Saharan Africa in 2010. Riddell (2008) states that ODA doubled from $27 billion to $53 billion from the year 1980 to 1990.

In 1984-85, the Ethiopian famine gave foreign aid a new face and it became popularly known as “Live Aid” (Moyo, 2009). The name “Live Aid “ was based on the 24-hour musical concerts that were held on every continent on the same day and televised live all over the world to raise funds and the profile of hunger in Ethiopian and the rest of Africa.
Before the famine, foreign aid had two strands: the political alliance strand and the second economic strand, which was aimed at improving the economic situation of the recently independent nations. Live Aid had no political or economic motive, but was simply a moral response to the plight of people dying from hunger in Ethiopia. Towards the end of the 1980s, emerging countries' debt was about US$1 trillion, which led to a reversal of cash flow

from poor countries to rich countries, which was estimated at US$15 billion (Moyo, 2009). This led to the decline of Africa's economic growth with high levels of poverty and rampant corruption. Donors now blamed the economic woes on poor political leadership and weak institutions. Donors then believed that countries in the sub-Saharan African region lacked good governance, in the form of the strong and credible institutions required for sustainable economic growth. The focus then shifted to governance and democracy, as a precondition for Africa's turn-around (Riddell, 2008).

### 2.5.4 The 1990s: governance, democracy and debt relief

The World Bank pledged to give aid on the condition that it be used for governance and democratic reforms, that is, improving civil service, government bureaucracy and democratic government. A democratic country is characterised by having political representatives that are chosen through open, free and fair elections, and the protection of civil and political liberties are a right of every citizen (Moyo, 2009).

Other major characteristics and events of the 1990s were: firstly, the dominance of multilateral agencies, namely the World Bank and United Nations Development Programme (UNDP), with their multilateral aid funding rising from 23 per cent to 30 per cent. Second was the onset of donor fatigue; Africa's total ODA was reduced from US$17 billion to $12 billion in 1999 (Riddell, 2008). Third was the Earth Summit, which took place in 1992, with world leaders coming together to discuss issues relating to poverty and environment and the whole question of sustainable development.

The 1990s saw another view beginning to emerge to explain why African was still failing to develop. Africa was heavily in debt and it was believed that if only the debt was written off in one instance, it could reach that level of economic development (Sachs, 1999). This led to the Jubilee Debt Campaign, with a wide range of NGOs coming together to lobby for the cancellation of the heavy debts incurred by the Third World. To this end, the heavily indebted poor country (HIPC) initiative by the IMF and the World Bank was established with the aim of ensuring that no poor country faced a debt burden it could not manage. This allowed the IMF to provide faster, deeper, and broader debt relief and strengthened the links between debt relief, poverty reduction, and social policies (Moyo, 2009). A way was paved for moral campaigners like the pop starts, the movie stars, new philanthropists and even Pope John Paul II lobbying for more aid.

In the midst of all this, the dependency theory emerged, too much aid it argued was detrimental to development, as it encouraged recipients to depend continually on aid as a source of finance (Riddell, 2008). This had a slightly negative effect on ODA, as it declined, but saw a rise in ODA for humanitarian assistance due to natural disasters and the effects of the Cold War (Riddell, 2008).

Towards the end of the 21st century, aid took on a different turn, shaped by the OECD report in 1996 called "Shaping the 21st Century" (Fee, 2008). The report recommended a few new ways of managing foreign aid to ensure that it was effective. It stressed the importance of recipient countries taking ownership and being accountable of their own development processes and frameworks and within that integrating foreign aid to support their revenue requirements. It called for a stronger and effective partnership between donors and recipients and amongst donors themselves. Critical in this report was the urgent requirement to rethink how foreign aid was being assessed and to focus more on the impact and less on how much is being given. This led to the definition of specific targets to be achieved, in the form of the Millennium Development Goals (MDGs) (Fee, 2008).

### 2.5.5 The 2000s – The era of Millennium Development Goals

The Millennium Development Goals (MDGs) have driven the agenda for development aid since 2000. The MDGs are eight international development goals established after the millennium summit of the United Nations in 2000, where the United Nations Millennium Declaration was adopted. These goals set concrete targets and indicators for reduction by 2015 (Fee, 2008).

In 2002 a UN summit was held in Monterrey, Mexico and its main purpose was to raise funding from the international community to implement and achieve the MDGs, as an additional $50 billion in ODA was required each year to ensure that the MDGs were achieved (Riddell, 2008). A commitment was made to reach a target of 0.7 per cent of GNP of the developing nations (Tandon, 2008). However, the financial crisis in 2008 and the move from the G8 to G20 changed the financial commitments to foreign aid and the strategic relationships that existed respectively (Moyo, 2009).

To help accelerate the MDG, the HIPC initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI). The MDRI allowed for 100 per cent relief on eligible debts by the three multi-lateral organisations (IMF, World Bank and African Development Bank).

Following on the UN summit in Monterrey, the UN set up an independent advisory board to devise a practical plan on how to achieve the MDGs. The board recommended that aid giving should be aligned directly to the needs of the recipient country. It estimated the aid levels would increase from $135 billion to $195 billion by 2015. It emphasised the need for each poor country to create and own its own strategy based on the MDGs with foreign aid financing any financial gaps that may be experienced (Riddell, 2008). However, Riddell (2008) criticises the report by the UN that it went on to prescribe how aid ought to be spent which was in contradiction to what it had earlier recommended on the recipients defining how they will spend the foreign aid. In 2005, Commission for Africa released another report called "Our Common Interest" which provided another blueprint from Sub Saharan Africa and called for a big push on aid and debt relief, recommending a doubling of aid for Africa from $25 billion to $75 billion by 2015 (Riddell, 2008).

Further improvements to development aid were made by the Paris Declaration on Aid effectiveness in 2005 and the G8 meeting at Gleneagles in 2005. The Paris Declaration's main aim was to make development aid focus more on outputs rather than inputs. The Gleneagles summit established a report that called for closer collaboration between the donors and the developed world (Tandon, 2009). The summit advocated that the prerequisite for eliminating poverty in Africa is the achievement of good governance, peace and security. Closer collaboration was also emphasised at the 2008 Accra Agenda for Action, and the 2011 Busan Partnership for effective development cooperation (Tandon, 2008). Both parties alike also wanted to know that aid would be used effectively as possible. However, after the terrorist attack of 9/11 in the USA, aid-giving became more political.

## 2.6 Foreign aid framework

This section of the study will discuss the current aid framework by outlining how the aid world is organised through the review of the aid organisations, the donors and the current levels of aid.

### 2.6.1 Aid organisations and donors

As mentioned, official aid falls into two main categories, namely bilateral aid and multilateral aid. Most official donors and organisations fall under one of these two categories. Riddell (2008) defines bilateral aid as aid provided by governments through their official agencies to an aid recipient country, whilst multilateral aid is aid provided to the recipient by an international organisation like the IMF or World Bank. Statistics state that there are over 100

large official aid donors increasing to 200 when other smaller agencies are included (Riddell, 2008). There is also another key component of aid and that is the aid provided by non-governmental organisations (NGOs).

#### 2.6.1.1 Bilateral donors

Over 95 per cent of bilateral official aid is provided by 23 members of the OECD Development Assistance Committee (Riddell, 2008). There are 5 main official bilateral aid donors. These are United States, United Kingdom, Japan, France and Germany. These five countries account for 66 per cent of all ODA provided by the OECD/DAC donors. They also contributed 60 per cent of the aid channelled via the multilateral agencies. There are other smaller bilateral donors who have donated more than $30 billion in ODA between the years 2000 to 2008. (Riddell, 2008). These are Australia, Austria, Belgium, Canada, Finland, Italy, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, Denmark, Greece, Ireland and Portugal. Riddell (2008) goes on to state that even though these countries are classified as small bilateral donors, they are, in most cases, a single large donor to a particular country. For example, Australia was the single largest donor to Papua New Guinea, and Italy the second largest donor to Mozambique during the years 2000 – 2008.

#### 2.6.1.2 Multilateral donors

Multilateral aid is favoured over bilateral aid by most donors, as it is viewed to be less politically driven and more likely to be channelled to recipients based on need and with fewer conditions. As of 2008, 90 per cent of multilateral aid was being provided by 15 main agencies. Riddell (2008) classified multilateral agencies into the following categories:

- First was the International Financial Institutions (IFI), which accounted for 44 per cent of ODA disbursements. The IFI consists of regiondl banks and lending institutions. The two main ones were the World Bank, which focused on fighting poverty and improvement of living standards and recently focuses on the MDGs and International Monetary Fund (IMF) which mainly focused on ensuring financial stability rather than broader development issues. Within the IMF and the World Bank there were other smaller agencies or institutions that implement the organisations core missions within countries;
- Second was the United Nation Agencies which accounted for 15 per cent of the total aid disbursements. Riddell stated that there were over 30 separate UN bodies and organisations involved in some humanitarian or development work. In addition to these there were other 6 or more UN agencies, termed the UN programmes and funds;

- Other multilateral agencies account for 40 per cent of all multilateral aid. The major ones were: The Global Environment Facility, The Montreal Protocol Fund and Arab/OPEC;
- The European Commission: Riddell (2008) categorised this organisation as a bilateral donor, but the OECD defined it as a multilateral agency. For the purpose of this study, we will classify it as a multilateral donor. The four largest contributors to the EU were France, Germany, Italy and the United Kingdom contributing almost 70 per cent of its budget; and
- NGOs: These were local and international organisations that called termed the "implementers", as they work with and deal directly with the recipients at the grassroots level, and they worked separately from government and non-profit organisations. The total aid value handled by NGOs was almost $24 billion, equivalent to over 30 per cent of ODA over the years 2000 - 2008. A major component of NGOs that received extensive publicity as having a major impact on the lives of people had been the world of micro-finance. The United Nations noted that micro-credit programmes have been an effective tool in poverty reduction and increased the number of poor people taking part in their economic and political environments (Riddell, 2008).

### 2.6.2 Levels of aid flows

Over 180 countries are currently receiving official aid as stated by Riddell (2008). Table 2.1 shows how these countries are classified into four categories: least development countries, lower income countries, lower middle income countries and upper middle income countries. Table 2.1 illustrates how these are broken down and what their per capital income levels are.

**Table 2:1: Total number of countries receiving ODA, as per their per capita income level**

| **Number of countries** | **Category** | **Per capita income levels** |
|---|---|---|
| 50 | Least developed countries | Below $745 |
| 21 | Lower income countries | Below $745 |
| 45 | Lower middle income countries | From $746 - $2975 |
| 32 | Upper middle income countries | $2976 - $9205 |

**Source: Riddell (2008).**

Table 2.2 illustrates the recent aid flows from the developing nations to the least developed nations. It showed that aid almost doubled from 2000 to 2014. Akramov (2012) stated that during the period 1965–2010, overall aid to LDCs rose from $5.8 billion to almost $90 billion, whilst aid to Africa rose from about $1 billion in 1965 to $30/40 billion in 2010. There was also a big push for more aid to Africa in 2009 and a call for more aid reformation, so as to focus on poverty reduction improvement (Abuzeid, 2009).

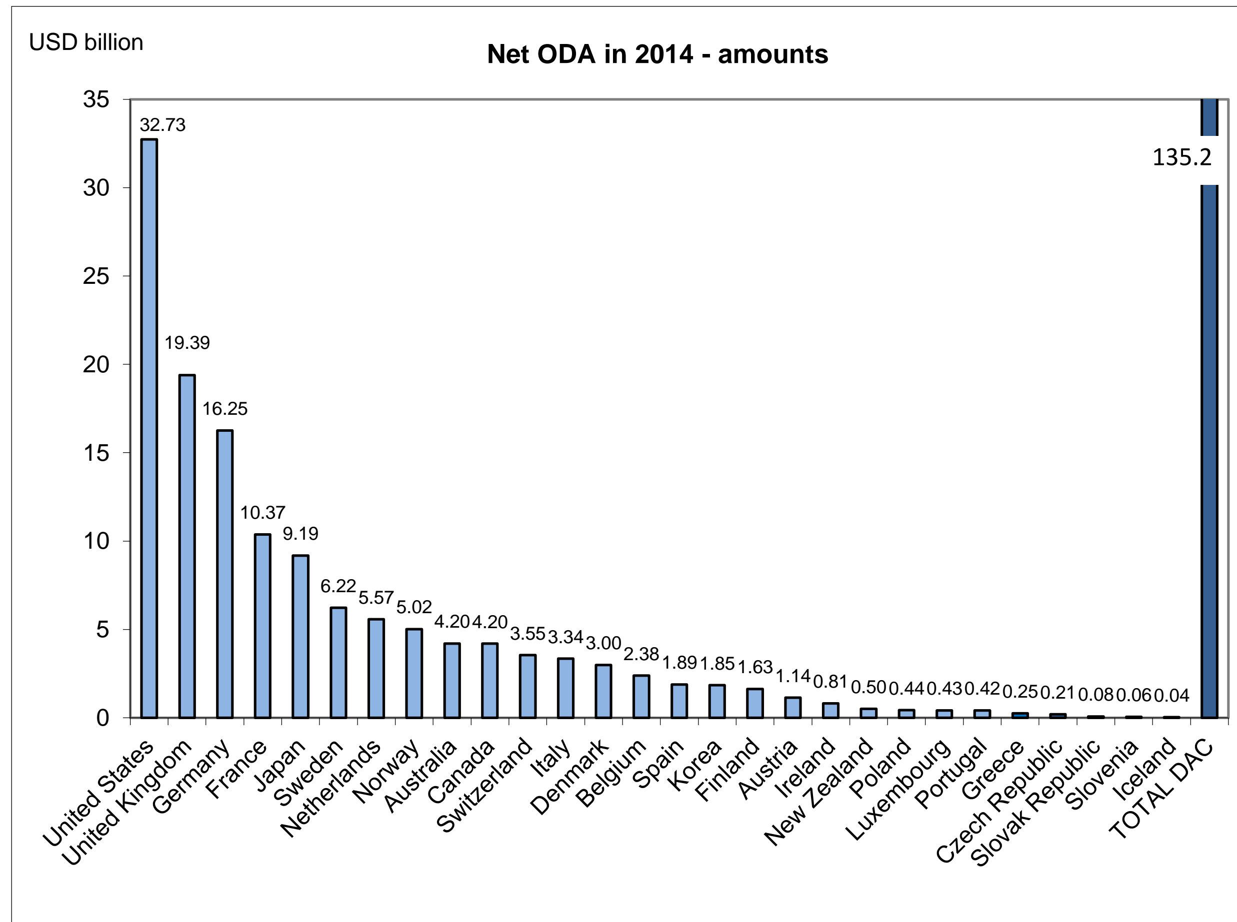
**Table 2.2: Levels of ODA - 2000 to 2014**

| Year | total ODA USD billion | ODA to LDC USD billion |
|---|---|---|
| 2000 | 59,301 | 21,413 |
| 2001 | 60,506 | 22,319 |
| 2002 | 62,893 | 25,961 |
| 2003 | 60,485 | 32,117 |
| 2004 | 66,049 | 31,628 |
| 2005 | 97,097 | 31,017 |
| 2006 | 87,340 | 34,629 |
| 2007 | 78,145 | 34,676 |
| 2008 | 86,627 | 38,913 |
| 2009 | 87,554 | 39,685 |
| 2010 | 89,018 | 45,756 |
| 2011 | 88,462 | 43,933 |
| 2012 | 87,321 | 40,299 |
| 2013 | 90,550 | 44,522 |
| 2014 | 96,546 | 37,837 (estimated) |

**Source: OECD (April 2015).**

Total of $135 USD billion of ODA is said to have been distributed in 2014, as per the (OECD). This is shown in Figure 2.1, which shows the levels of levels of ODA provided by the leading OECD donors for 2014. Until 2016, USA was the leading ODA donor, followed by the UK, Germany and France. Recently, China has been see to be on top of the list of donors even though its total ODA is not officially released (OECD, 2016).

**Figure 2.1: Levels of net official development assistance in 2014**




**Source: OECD (April 2015).**

### 2.6.5 Aid governance

The above list of organisations gives a clear indication of how complex the aid world is; however, as Riddell (2008) notes, there is not and has never been a master plan that governs the activities of the world of aid. This in itself presents a major setback to the aid world, which will be discussed in the section below. However, steps are being taken by all the main parties involved to implement concrete measures to coordinate their activities and align them to the strategies of the aid-recipient countries and centralising the disbursement of funds.

## 2.7 Aid dependence

It is important to understand what aid dependence means, as not all countries that receive foreign aid are deemed to be dependant and require exit strategies. The World Bank's World Development Indicators have defined aid dependence as the ratio of net official aid flows to gross national product. Riddell (2008) has called aid dependence the process by which the continued provision of aid appears to be making no significant contribution to the achievement of self-sustaining development. Other commonly used explanations for aid dependence are: a situation in which a government is unable to perform many of the core functions of government without foreign aid funding and technical skills; dependence is reliance on others, lack of self-sustenance and self-sufficiency and it may be costly to forego foreign aid (Baldwin, 1980). Moon (1983) states that the donors then establishes a dependent relationship generating a degree of control and influence, and as stated in the previous section one of the main use of aid in the potential to control. Control is gained in a number of ways. Firstly, the continuous and excess demand for aid places the donor in a bargaining position, enabling the donor to give conditional aid, for example, donors interfering in the fiscal, monetary, development policies and project management. Secondly, it is the debt position in which recipients finds themselves in unable to repay these large amounts of debt (Moyo, 2009). This has resulted in most African countries trembling in horror if they are threatened with the withdrawal of aid accepting unreasonable policies and conditions (Babu, 1981). Aid is viewed as a narcotic, fostering addictive behaviour among states that receive it (Goldsmith, 2001).

The World Bank has a formal way that aid dependence is measured. Outlined below are the different indicators used to measure aid dependence, as suggested by McPherson and Gray (2000):

- The period that a country has been receiving aid; the majority of African countries have relied on aid since the early 1960s;
- The level of external debt that is serviced by foreign aid;
- The level of Imports that use foreign aid assistance;
- The state of their budgets and balance of payments deficits, as most African countries have managed their deficit by using foreign aid;
- Reduction in the debt stock resulting from foreign aid; most African countries still rely on foreign aid to service their debt; and
- The percentage of the health, education, and infrastructure budgets that are being funded by aid.

Based on the above criteria, McPherson and Gray (2000) concluded that most African countries have and are still highly aid dependent. However, none of these indicators alone is a decisive factor, but collectively a reliance on aid may be identified.

## 2.8 Conclusion

This chapter focused on the transformation journey that economic development theory took and the role of foreign aid within that journey. The chapter commenced by highlighting the different definitions and types of foreign aid. The definition of foreign aid varied, with the OECD (2015) defining aid as those flows, being cash, commodities or services given directly or indirectly to countries. Hattori (2001) defined aid based on three perspectives, firstly political realism view where aid was defined as a political tool; secondly, aid as a liberal internationalism set to influence the socio-economic and political development of recipient countries; and lastly aid as a world system theory where aid is a means to hinder the development path of recipient countries. The chapter then focused on the determinants of foreign aid and aid allocation, to understand who is giving aid to whom and why. Studies have shown that the need to give is driven by both the donors' political and economic needs and the interests of the recipient countries. Riddell (2008) also highlighted a number of ethical theories that influences the donors' decisions to give, namely, utilitarianism, theories of justice, capabilities approach, rights based perspective and obligations perspective.

Four different theories on economic growth, which motivated the need for foreign aid, followed the discussion. Foreign aid as a policy was backed up by a number of economic theories that proved that savings and investments has a direct impact on a country's GDP, and that aid will provide the savings required. First, the Harrod and Domar Model of 1946 stated that a country's rate of growth is dependent on the level of savings and the productivity of capital, labour and technology. Second, Rostow's Stages of Growth theory was outlined. It postulates that for an economy to grow, it should pass through five stages of maturity with the appropriate capital accumulation and investments. Third, the "Big-Push" Theory of Rosenstein-Rodan was discussed, which stressed the importance of large amounts of investments to be given to LDCs and not "bit by bit to be pushed onto a path of sustainable economic development. The theory argues that "bit by bit" investments leads to wastage of resources and not the desired outcome. Last, the Two-Gap theory of Chenery and Strout was discussed. This theory highlights the importance of foreign aid as a financial enabler that fills the two gaps of savings and foreign exchange.

The chapter then outlined the chronological order of events that shaped foreign aid policy. The study analysed the different phases that foreign aid has gone through. The discussion traced how foreign aid, as a concept, evolved from the colonisation era of the 19th century to the present state where foreign aid is commonly viewed under the umbrella of the MDGs (Moyo, 2009).Foreign aid as a concept commenced in the 19th century, where the European and British power expanded and colonised Africa and the entire world. This was entrenched in the Colonial Development Act of 1929, where grants were given to poorer countries. This was followed by the enactment of the League of Nations under Article 22 after the 1st World War, arising out of the need to maintain world peace and ensuring good labour conditions. The League of Nations was replaced by the United Nations 26 years later. Another major event that shaped foreign aid was the end of the Second World War, which saw the Bretton Woods System emerging in 1944. The aim was to redesign the international finance system to avoid the great depression (Moyo, 2009). This saw the birth of the IMF and the IBRD.

The year 1947 was characterised by the Marshall Plan and the beginning of the Cold War (Moyo, 2009). The focus during this period was the rebuilding of Europe under the European Recovery Programme. This decade saw colonisation coming to an end and the Cold war facilitating another route on how the west could still have the strategic geopolitical holds over the LDCs. The Truman Doctrine of 1949 enhanced the Cold War, where the USA declared that they would provide assistance to all democratic nations under threat from internal or external forces.

From the 1950s to 1970s was termed the golden age of development aid where foreign aid was at its peak. Various institutions were opened to facilitate the process, for example, The European Development in 1958 and the United States Agency for International Development (USAID).

By the 1970s the effectiveness of was being questioned as poverty levels were still high (Fee, 2012; Moyo, 2009; Tandon, 2008). This saw the change in strategy towards poverty eradication and aid moved into the era of poverty alleviation focusing in the education, health and water sectors. Aid flows begun to fall due to the oil crisis in 1973 (Fee, 2012; Moyo, 2009; Riddell, 2008). The situation did not improve in the 1980s which was termed the lost age of development as economies continued to struggle due to the Iran-Iraq war (Moyop, 2009). Neo-liberal policies were introduced in the form of the Stabilisation and Structural Adjustment Programmes (Moyo, 2009). Another important aid feature of the 1980s was the Live Aid phenomenon which was based on the 24 hour musical concert to raise money for the Ethiopian famine. Towards the end of the1980's the emerging country debt levels were very high and saw the reversal of cash flow from poor countries to rich countries and a decline of the African economy (Moyo, 2009). Lack of proper governance structures was blamed for the failure of aid to assist in economic growth. Aid then focused on governance and democracy as a precondition for economic turn-around in the 1990s (Riddell, 2008). The 2000s was the era of the Millenium Development Goals were concrete developmental targets were set with a deadline of 2015. Post 2015 the Millenium Development Goals met their objective of halving poverty in half and the Sustainability Goals were then set.

To contextualise how the aid world functions, the aid framework was briefly discussed, highlighting the structure of the different bilateral and multilateral donors and organisations. the aid world is organised and governed by the different bodies and organisations. Current aid donors, recipients and flows were also highlighted, with over 180 countries still receiving foreign aid, with over $135 USD billion of ODA having been distributed (Riddell, 2008). The chapter concluded with the definition of Aid dependence, and what is means for a country to be aid dependent. The World Bank indicators defines aid dependence as the ratio of the net official aid flows to gross national product (Riddell, 2008). According to study by McPherson and Gray (2000) most African countries are highly dependent on aid.

# CHAPTER 3

# LITERATURE REVIEW ON THE CURRENT STATE OF FOREIGN AID

## 3.1 Introduction

There are various elements and trends that have dominated the discussions on foreign aid since its inception fifty years ago. Foreign aid trends, effectiveness of aid, criticisms of aid and constraints faced by the aid world are some of the factors that have been key in these discussions. This chapter of the study will conduct a theoretical review of these key elements, to not only gain an understanding of the current state of foreign aid, but also to have a contextual background needed to understand why there is a call to end foreign aid dependency. Briefly these elements are: the current foreign aid levels and trends; the impact of aid on economic development; factors that have influenced the research studies conducted on aid effectiveness; the constraints and reforms to the foreign aid world and finally criticisms made against foreign aid. Outlined below is the structure and content of this chapter.

The chapter commences with Section 3.2, which is an analysis of the current foreign aid trends and flows. This will entail a review of the following aid flow categories: net official development assistance (ODA) disbursements for the years 2005-2014, highlighting the aggregated levels of ODA, list of ODA recipients for the years 2013-2014; ODA allocation per sector for the years 2013-2014; foreign aid dependency levels depicting the list of top ten foreign aid dependent countries for the years 2000–2015; the projected ODA figures for the next three years. The data used will be from the Organisation of Economic Cooperation and Development (OECD).

The literature review on the debates between aid and economic growth is detailed in Section 3.3. The analysis is given within the analytical framework depicted in Figure 3.3, which provides a contextual view of how foreign aid has been transmitted through various economic variables to impact economic growth. The framework simply highlights the fact that foreign aid has been used indirectly through a number of transmission mechanisms to achieve certain levels of economic growth (Akramov, 2012; Gomanee et al., 2005). The discussion will mainly be based on a few prominent case studies that have been conducted on the impact of foreign aid focusing on a number of key economic variables.

Section 3.4 follows, which is a discussion on the factors that have influenced the results on foreign aid research, and why most studies have found it difficult to give a conclusive answer as to whether foreign aid has been effective or not.

In Section 3.5, the discussion focuses on the constraints that the foreign aid world has experienced in the last fifty years. Embedded in these discussions are the potential solutions to these constraints, as most academics still believe that aid has a huge role to play in development.

Section 3.6 provides a discussion of the criticisms that have been levelled against foreign aid and why some commentators are calling for an end to it. This is followed by a discussion on reforms that have been proposed to ensure aid is effective in section 3.7. Section 3.8 concludes the chapter by summarising the main points and issues raised in this chapter of the study.

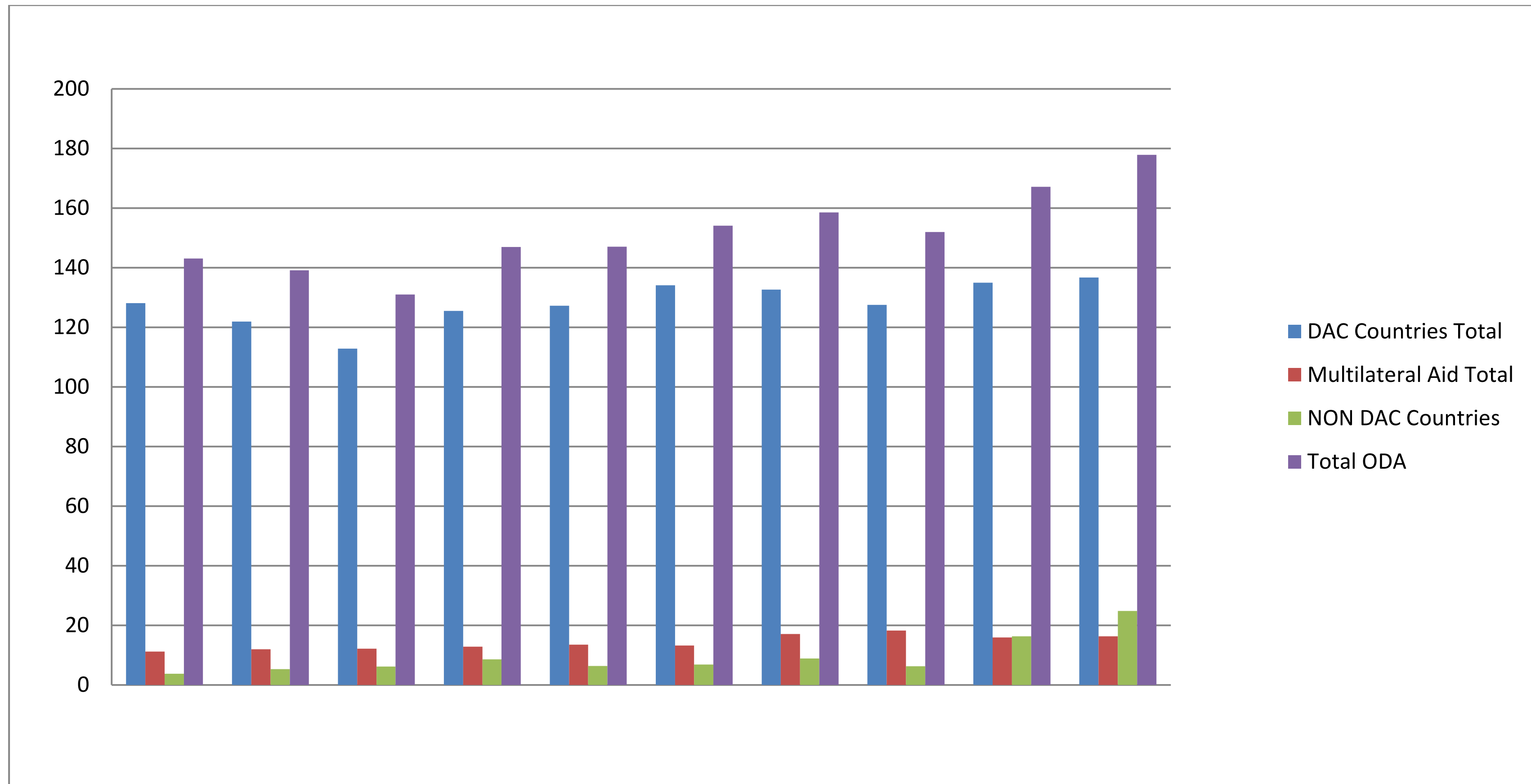
## 3.2 Trends in current foreign aid flows

### 3.2.1 Official development assistance disbursements

Four main indicators of foreign aid will be briefly highlighted in this section to give a general overview of the current foreign aid flows. These are: Net ODA Disbursements, ODA allocation, foreign aid dependency levels highlighting the top ten foreign aid dependent countries, and the future trends of ODA.

Akramov (2012) states that overall foreign aid flows have been constant, with an average compound growth rate of about 2.4 per cent per year for the past ten years. Table 3.1 shows the foreign aid disbursements for 2005–2014 at 2013 constant prices. These figures were released by the OECD in 2016. Figure 3.1 is a graphical view of these figures. Briefly, the data shows that 2014 saw an aggregated net ODA of $177.8 billion, with: $137.7 billion from the DAC members, $16.3 billion from multilateral aid, and the balance of $24.8 billion from non-DAC members. A decline in ODA is seen in 2007 and 2012 of about 3–5 per cent; however, these drops in aid flows were temporary, as it picked up again the very next year in both periods.

**Figure 3.1: Net total ODA disbursements (2005-2014)**




**Source: OECD (January 2016).**

**Table 3.1: Net Total ODA Disbursements (2005 – 2014)**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| DAC Countries Total | 128.1 | 121.9 | 112.8 | 125.5 | 127.2 | 134.1 | 132.6 | 127.5 | 134.9 | 136.7 |
| Multilateral Aid Total | 11.2 | 11.9 | 12.1 | 12.8 | 13.5 | 13.2 | 17.1 | 18.2 | 15.9 | 16.3 |
| Non-DAC Countries | 3.7 | 5.3 | 6.1 | 8.6 | 6.3 | 6.8 | 8.8 | 6.2 | 16.3 | 24.8 |
| Total ODA | 143 | 139.1 | 131 | 146.9 | 147 | 154.1 | 158.5 | 151.9 | 167.1 | 177.8 |

**Source: OECD (January 2016).**

The OECD (2016) reported that the drop in aid flow seen in 2012 was due to austerity measures, as governments cut their aid budgets. The data further highlights that 2013 saw the highest increase in foreign aid flows ever recorded, 6.1 per cent in real terms, and providing a total of USD 167.1 billion (OECD, 2016). Over the past 10 years, aid flows from non-DAC countries has seen an increase of over 20 per cent indicating a much larger involvement of non-DAC countries in foreign aid donation. In comparison, multilateral aid has not seen much of a substantial increase in the past 10 years with only an increase of 5 per cent only. The DAC countries are still the largest contributors of foreign aid. Overall, the figures are showing that foreign aid is still an important part of LDCs and not showing any signs of easing or stopping.

A further look of ODA from the DAC members only was conducted. The figures are depicted in Table 3.2. The United States of America (USA) still continues to be the largest donor, giving a total $33.1 billion in 2014. Table 3.2 also shows that the United Kingdom (UK) met its 0.7per cent ODA/GNI target for the very first time in 2013/14 (OECD, 2016). Out of the 28 DAC members, an overall decrease in aid flows has been recorded from 9 countries, with Spain recording the highest drop (20.1 per cent) in contribution to ODA. The OECD data also reported that the United Arab Emirates posted highest ODA/GNI ratio of 1.25 per cent, after its assistance to Egypt in 2016.

**Table 3.2: DAC Members' Net Official Development Assistance in 2014**

| Donor Country | 2014 | | 2013 | | % change |
|---|---|---|---|---|---|
| | ODA (USD million) current | ODA/GNI % | ODA (USD million) current | ODA/GNI % | 2013 to 2014 (in real terms) |
| Australia | 4 382 | 0.31 | 4 846 | 0.33 | -3.2 |
| Austria | 1 235 | 0.28 | 1 171 | 0.27 | 3.8 |
| Belgium | 2 448 | 0.46 | 2 300 | 0.45 | 6.0 |
| Canada | 4 240 | 0.24 | 4 947 | 0.27 | -9.7 |
| Czech Republic | 212 | 0.11 | 211 | 0.11 | 4.0 |
| Denmark | 3 003 | 0.86 | 2 927 | 0.85 | 1.8 |
| Finland | 1 635 | 0.60 | 1 435 | 0.54 | 12.5 |
| France | 10 620 | 0.37 | 11 339 | 0.41 | -7.0 |
| Germany | 16 566 | 0.42 | 14 228 | 0.38 | 14.2 |
| Greece | 247 | 0.11 | 239 | 0.10 | 5.8 |

| | | | | | |
|---|---|---|---|---|---|
| Iceland | 37 | 0.22 | 35 | 0.25 | 1.4 |
| Ireland | 816 | 0.38 | 846 | 0.46 | -3.7 |
| Italy | 4 009 | 0.19 | 3 430 | 0.17 | 16.5 |
| Japan | 9 266 | 0.19 | 11 582 | 0.23 | -14.6 |
| Korea | 1 857 | 0.13 | 1 755 | 0.13 | 1.2 |
| Luxembourg | 423 | 1.06 | 429 | 1.00 | -2.0 |
| Netherlands | 5 573 | 0.64 | 5 435 | 0.67 | 1.6 |
| New Zealand | 506 | 0.27 | 457 | 0.26 | 7.6 |
| Norway | 5 086 | 1.00 | 5 581 | 1.07 | -3.1 |
| Poland | 452 | 0.09 | 487 | 0.10 | -8.2 |
| Portugal | 430 | 0.19 | 488 | 0.23 | -12.6 |
| Slovak Republic | 83 | 0.09 | 86 | 0.09 | -2.8 |
| Slovenia | 62 | 0.12 | 62 | 0.13 | -0.1 |
| Spain | 1 877 | 0.13 | 2 348 | 0.17 | -20.1 |
| Sweden | 6 233 | 1.09 | 5 827 | 1.01 | 11.2 |
| Switzerland | 3 522 | 0.50 | 3 200 | 0.46 | 8.4 |
| United Kingdom | 19 306 | 0.70 | 17 871 | 0.70 | 0.7 |
| United States | 33 096 | 0.19 | 31 267 | 0.18 | 4.2 |
| **TOTAL DAC** | **137 222** | **0.30** | **134 832** | **0.30** | **1.2** |

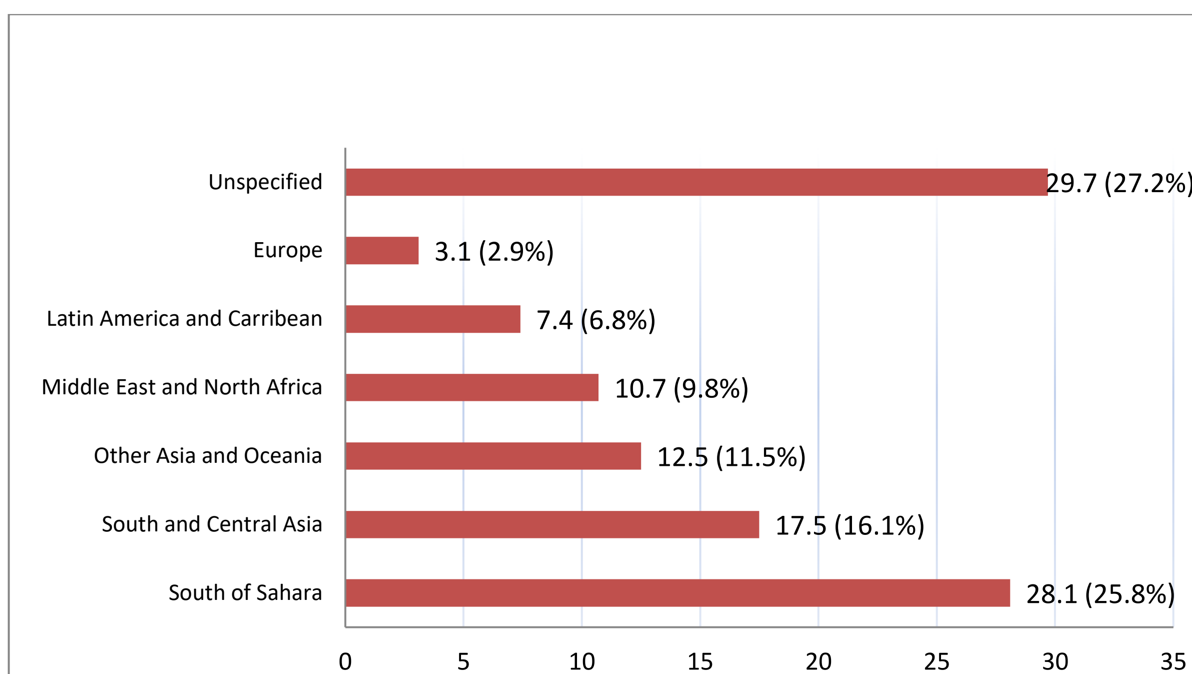
**Source: OECD (January 2016).**

### 3.2.2 ODA allocation

Figure 3.2 below shows how ODA was allocated in 2013-2014. Sub-Saharan Africa still is the largest recipient of ODA, receiving a total of $28 billion, followed by South and Central Asia. However, a larger percentage of 29 per cent is unspecified.

ODA was targeted across a wide range of sectors, but mainly focused on eight main sectors. Education, Health and Population was the sector that received the highest funding allocation for 2013-2014, indicating a shift towards health and education and away from infrastructure (OECD, 2016). Programme-based aid had the lowest allocation, showing that programme-based aid is not receiving as much aid as it did in the initial aid years. Economic and social infrastructure are still key sectors in the development journey with each being allocated 18.9 per cent and 17.6 per cent, respectively.

**Figure 3.2: ODA Recipients by Region (USD million) 2013 – 2014**




**Source: OECD (January 2016).**

**Table 3.3: Allocation of ODA by sector 2013 – 2014**

| Sector | % Allocation |
|---|---|
| Unspecified | 11.5% |
| Humanitarian Aid | 10.90% |
| Programme Assistance | 3.4% |
| Multi-sector | 9.4% |
| Production | 6.8% |
| Economic Infrastructure | 18.9% |
| Other Social Infrastructure | 17.6% |
| Education, Health and Population | 19.7% |

**Source: OECD (January 2016).**

### 3.2.3 Foreign aid dependency levels

Foreign Aid dependency is simply the percentage of foreign aid in the recipient's gross national income. The level of aid dependency was very high for most sub-Saharan countries in 2000-2004, as stated by Akramov, 2012). This is highlighted in Table 3.3 below, where 7 of the 10 countries were sub-Saharan countries. When a comparative analysis is conducted for 2011–2015, using data from the OECD, as shown in Table 3.3, the data shows the following trends:

- Only 4 countries that are on the top 10 list are from Africa, a drop from 7 countries in the years 2000-2004 (OECD 2016).
- 6 of the countries that were on the top 10 list have now reduced their foreign aid inflow percentage. These are Guinea Bissau, Sierra Leone, Eritrea, Congo, Burundi and Mozambique (OECD 2016).
- Malawi is the only African country that has still stayed on the top 10 list from 2004, with an increase of 5per cent in its foreign aid inflow (OECD 2016).
- 3 new African countries have moved into the list of the top 10 recipients; these are Liberia, Somalia and Burundi. Interestingly, even though Liberia has moved onto the top ten recipients it is on a decreasing rate, as the figures shows that in 2011 the rate was at 53.8 per cent, compared to the recent figure of 32.5 per cent in 2013 (OECD 2016).

**Table 3.4: ODA Dependency Trends/Levels for 2000/04 and 2011/15**

| Top 10 recipients of Net ODA/OA Inflows (% of GNI) 2000-04 | | | Top 10 recipients of Net ODA/OA Inflows (% of GNI) 2011-15 | |
|---|---|---|---|---|
| Micronesia | 47.0 | | Tuvalu | 48.3 |
| Guinea Bissau | 38.9 | | Micronesia | 41.8 |
| Sierra Leone | 35.9 | | Marshall Islands | 41.5 |
| Eritrea | 35.5 | | Liberia | 32.5 |
| Congo, DRC | 32.1 | | Malawi | 30.3 |
| Burundi | 31.2 | | Solomon Islands | 27.4 |
| Mozambique | 30.5 | | Afghanistan | 24.0 |
| Afghanistan | 30.4 | | Kiribati | 23.2 |
| Solomon Islands | 26.2 | | Somalia | 20.1 |
| Malawi | 25.2 | | Burundi | 201 |

**Source: OECD (January 2016).**

Stanford (2015) states that, since 2000, the level of aid dependency has reduced by one-third in most LDCs, and as seen in Ghana and Mozambique, that is from 47 per cent to 27 per cent, and from 74 per cent to 58 per cent, respectively. However, there is another form of dependency that is not financially related and that is on the increase: political dependency (Stanford, 2015). Foreign aid conditionality, tied aid and grants have led to donors being more involved in the political processes of the recipient country. This has led to a rise in political dependency and lack of accountability of the government to its citizens.

### 3.2.4 The future of foreign aid

The OECD further depicts the future outlook on foreign aid flows based on the developing countries' gross receipts of Country Programmable Aid (CPA). The OECD survey suggests the following CPA outlook figures are predicted for the next three years:

- Focus will be on the middle income countries facing extreme poverty, the following countries were highlighted, Brazil, China, Chile, Georgia, India, Mexico, Pakistan, Sri Lanka and Uzbekistan, where CPA increases of 5 per cent are expected up to 2017 (OECD, 2016);
- Decline to low income countries of 5per cent is expected, due to the reduced access to grant resources (OECD, 2016);
- Allocations to Africa and Asia are predicted to be equal by 2017 (OECD, 2016); and
- Overall CPA is set to increase at an average of 2.4per cent and is predicted to remain stable going forward (OECD, 2016).

Overall foreign aid flows are expected to still increase, as predicted by the OECD for the next three years. However, the allocation to sub-Saharan countries is set to decline, despite the call for more aid to this region (OECD, 2016). LDCs continue to be the highest recipients of foreign aid (OECD, 2016). On the more positive outlook foreign aid dependency is stated to be on the decline for most countries. Despite this growing need for foreign aid, its effectiveness is still highly questioned and debated, and that is the discussion of the next section.

## 3.3 Impact of foreign aid on economic growth

The question of whether aid has had the desired impact on economic growth is still being debated by economists and the world at large, but it is yet to be conclusively answered. The proponents of foreign aid have argued that despite its shortfalls and weaknesses, foreign aid has contributed towards poverty reduction and growth in certain countries, assisted in technological advancement and capacity building in others. This view is supported by popular economists like: Sachs (2005); Stiglitz (2002); Burnside and Dollar (2000); Haemic and Iran oust (2005). Sachs (2005) went further by calling for doubling of foreign aid flows from rich countries in an effort to end poverty.

In contrast, other economists have argued that foreign aid has not been effective in eradicating poverty, but instead merely encouraged corrupt government, enriched the elite in poor countries, importation of inappropriate technology and distorts domestic income distribution (Friedman, 1958; Griffin, 1970; Griffin and Enos, 1970; Weisskoff, 1972; Bauer, 1972; Boone, 1994 and 1996; Tandon, 2008; Moyo, 2009; Easterly, 1997; 2007; 2003). As a result, theorists like Moyo (2009) and Tandon (2008) have been calling for an end to foreign aid. This section of the study will review existing literature on foreign aid and economic growth relationship. The analysis will mainly be done by reviewing existing case studies that have been conducted by various economists on the topic.

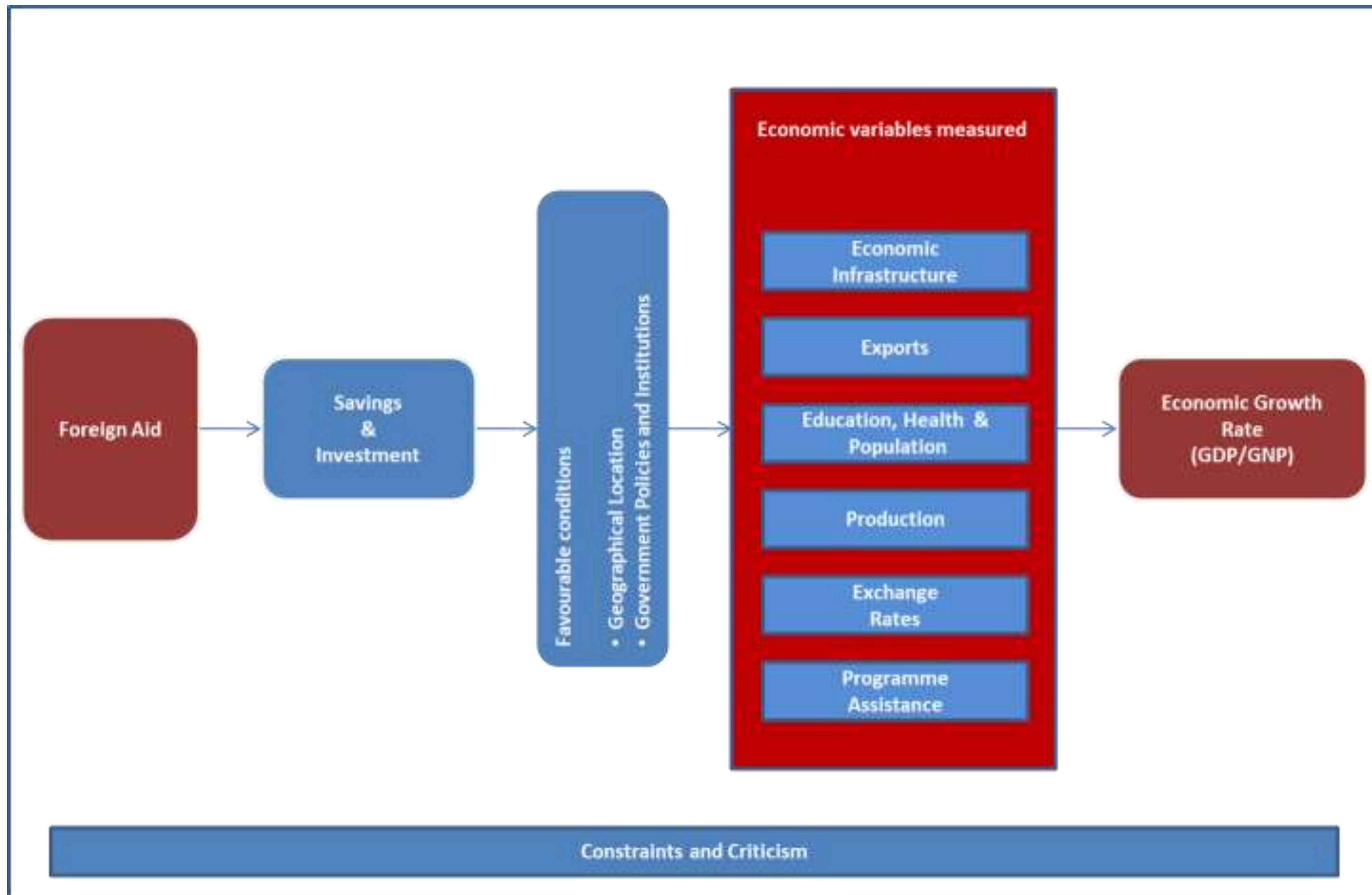
### 3.3.1 Foreign aid and economic growth transmission

Figure 3.3 indicates the transmission process in which foreign aid commonly follows to impact economic growth. The figure has been designed and adapted from Akramov (2012) and Gamine et al. (2005). The framework has been developed to aid in understanding the typical transformation journey that foreign aid usually undertakes to reach the desired end goal of boosting a country's economic growth (Akramov, 2012; Gamine et al., 2005).

Firstly, it shows that foreign aid is initially injected into a country's savings to boost its investment level and productivity, as explained by the growth theories of the Harrod and Domar Models (1946) and the Two-Gap Theory (1960). Chapter 2, section 2.3 of the study goes into detail regarding these growth theories. Secondly, the figure depicts the desired impact on economic growth is in most cases achieved indirectly through a number of transmission mechanisms that foreign aid will target to attain a certain level of growth rate (Akramov, 2012). Typically, foreign aid is injected into certain variables to boost economic activity. These variables may be: infrastructure (Serven, 2010), education, health and population (United Nations, 2010) and exchange rates (Riddell, 2008).

The framework also highlights a few critical conditions that have been identified to assist in foreign aid being effective, these being geographical location (Gallup et al., 1998; Arndt et al., 2009) and good governance (Burnside and Dollar, 2000). Each of these variables have been depicted in the diagram below and the discussion will review case studies that have directly studied the reaction of these variables to foreign aid.

**Figure 3.3: Foreign Aid and Economic Growth Transmission Analytical Framework**




**Source: Akramov (2012); Gomanee et al. (2005).**

### 3.3.2 Favourable conditions for foreign aid

Questions were being asked as to why foreign aid seemed to work in a few countries unlike others and this led to studies being undertaken to understand the reasons why. Two main conditions that were identified as being favourable for aid to work effectively were good government policies and institutions, and geographic location (Gallup et al., 2008; Burnside and Dollar, 2000).

3.3.2.1 Government institutions and policies

One of the popular case studies that came up with foreign aid conditionality that good government institutions and policies were important in aid effectiveness was that of Burnside and Dollar (2000). Burnside and Dollar (2000) found that aid was effective in countries with good economic policies. Their study was conducted using data from 56 countries for the period 1970 to 1973 and again for the period 1990 to 1993, using budget surplus, inflation rate and country's openness as the policy variables in their regression model. Their recommendation was that foreign assistance should be prioritised to countries that had good policies to ensure its intended objectives were achieved. This conditionality was not well received by other development economists, as they believed that foreign aid worked in countries regardless of whether it had good policies or not. Various studies were conducted to counter-argue Burnside and Dollar's finding.

Hansen and Tarp's (2000) study was one of those studies that were commissioned with the sole objective of validating Burnside and Dollar's finding. They examined the aid-growth relationship utilising the same regression model as Burnside and Dollar. Their evidence indicated that aid increased growth rate with diminishing returns and was not based nor dependant on the country's policies. They also found a one-to-one relationship between increased aid flows and increased investment, stressing the importance of foreign aid-investment-growth transmission.

Easterly et al. (2000) also conducted robustness check on the Burnside and Dollar finding by adding new data to their regression models. They extended Burnside and Dollar's data from 1993 to 1997 and found that Burnside and Dollar's finding did not hold when additional data is included. They went on to state that their paper was not meant to question the effectiveness of aid, but to caution policy makers not to make decisions based on Burnside and Dollar's finding, as good policy is not a panacea to aid being ineffective. In an effort to quieten the critics, Burnside and Dollar, revisited their findings in 2004. A new data set from

the 1990s was used and they argued that their original finding still holds. Aid triggers growth in countries with good institutions and policies.

However, Riddell (2008) confirmed Burnside and Dollar's finding that aid worked in countries with good institutions. For example, countries like Korea, Botswana, Indonesia, Mozambique and Uganda, had successful results as a result of foreign aid. Countries where aid did not work due to bad institutions and policies were Haiti, Liberia, DRC and the Philippines (Riddell, 2008). However, Riddell (2008) cautioned that his finding does not indicate that aid never works with countries with bad institutions or policies. Radelet et al. (2004) showed that aid helped support growth in Mozambique and Uganda after their civil wars even though they had poor policies and institutions.

3.3.2.2 Geographic location

The second major conditionality was that of geographic location and climate. Gallup et al. (1998) stated that location and climate tend to have a marked effect on the economic growth of a country, as the countries exhibit a positive return on transport costs, disease burden and agricultural productivity. This was again proven by Daalgard et al.(2004), when they investigated the relationship between aid and climate-related variables. Firstly, they found that aid seemed to have been less effective in countries with un-favourable geographic location like the tropics. They believed that this may have been a result of the type of climate in the country impacting on productivity and how capital and labour was combined in the agricultural function (Daalgard et al.2004). Secondly, they believed that climatic conditions tend to influence the development of a country's institutions. Their study also revealed that the relationship between aid and policy was weak, contrary to Burnside and Dollar's finding (Daalgard et al. 2004).

Arndt et al. (2009) also conducted a study to understand the aid-growth relationship by focusing on indicators like human capital and geographic conditions like primary schooling, coastal population density and malaria risks. Their results revealed that the long-run positive effects were strongly confirmed and were robust in areas with favourable conditions. They concluded that foreign aid remained a critical element for the growth of LDCs and the suggestion that aid to Africa should cease is not warranted, as it is based on fragile evidence.

In contrast to the above case studies Rajan and Subramanian (2005) found a negative correlation between aid and growth. They also found no evidence that aid favoured areas with good policies or better geographical environments, or that certain types of aid worked

better than others. Their study involved a comprehensive framework that included the robustness of aid-growth relationships across the different areas: medium and long run; different time periods: 1960s through 1990s, different sources of aid: multilateral and bilateral aid, types of aid: economic, social, food, timing of impact: short-term versus long-term, cross sectional and panel samples. The study revealed a negative relationship between aid and growth in the long run, that is, over the 40-year period. However, they found a certain level of positive relationship in the panel data, but only when outliers were included, which made it difficult for them to clearly identify a systematic effect of aid on development. They admitted that the entire exercise of running cross country growth regressions is subject to issues of data integrity making it hard to establish a concrete relationship. They further asserted that even though their results showed this negative correlation, the do not conclude that aid is not useful or beneficial, but believe that aid will yield the expected results when applied correctly. However, these results were proved wrong by Arndt et al. (2009) who used the same data that Rajan and Subramanian (2005) had used and found that aid had a positive impact on growth if climatic conditions were favourable.

### 3.3.3 Transmission mechanisms

#### 3.3.3.1 Savings and investment

The main basis for ODA was to close the savings gap in countries that lacked financial resources to achieve a certain growth rate. The underpinning aid–growth theories of Harrod-Domar Model (in 1946) and Two-Gap Theory (in 1962) have been explained in Section 2.4 of the study. Outlined below are a few case studies that focused on understanding the impact of foreign aid on growth through savings and investment.

One of the early generation studies to prove that foreign aid has a positive effect on growth through savings was conducted by Papenek (1973). He carried out a cross-country regression analysis of 34 countries in the 1950s and another on 51 countries in the 1960s. He found that aid was given to countries with low savings rate and balance of payment constraints, had a significant impact on growth than their own savings or other forms of foreign inflows. This indicated a positive effect between foreign aid and growth. He also discovered that there was no significant impact between growth and levels of exports, education, size of manufacturing sector, per capita income and the population size of the country.

Another study that was aligned to the early growth theories on the importance of savings, in particular the Two-Gap Theory was that of Fayissa and El-Kaissy (1999). They conducted a study of 80 countries for the period 1971 to 1990, and their results showed that aid assisted in development in LDCs by supplementing savings.

Gomanee et al. (2002) contributed to the aid-growth debate through investment by conducting a study using a sample base of 24 sub Saharan African countries between the periods 1970 to 1997. Their study investigated the role of aid on growth through investment; the study excluded government policies, political and economic instability. The results revealed that foreign aid targeting investment had a significant positive effect on growth, and therefore blaming foreign aid as being the cause for Africa's poor growth is unwarranted. They further stated that, on average, a one percentage point increase in aid resulted in one-third of a percentage point in the growth rate.

Hatemi and Irandoust (2005) also provided empirical evidence on the aid-growth relationship through savings of a few developing countries, Botswana, Ethiopia, India, Kenya, Sri Lanka and Tanzania. Their estimated long-run elasticity revealed that Swedish foreign aid had a positive effect on the economy of the countries in their sample. The study revealed that foreign capital flows had a positive effect on real income by supplementing the savings gap. However, Griffin (1970), conducted a study of 32 under-developed countries, utilising data from the United Nations, in which he found a negative relationship between aid and savings. His analysis revealed that foreign assistance led to a reduction in domestic savings, disagreeing with the Harrod and Domar's (1946) growth model. Griffin (1970) gave three different examples of how this may occur. Firstly, a reduction in public savings may occur either through a change in government expenditure or a fall in tax receipts. Griffin (1970) believed that an inflow of aid will cause governments to increase public consumption and relax their efforts in tax collection. Secondly, he argued that foreign aid may reduce private domestic savings, as the availability of credit finance may reduce the incentive for local investors to save. Lastly, he found that foreign aid may encourage the consumption of imports and exports. Foreign aid increased the availability of imports which automatically increases their consumption. Griffin (1970) also believed that government policies may reduce the effort geared towards exports and increasing domestic consumption of possible exports.

In the same way Boone (1994) contributed to the aid-growth debate by conducting a study using data on non-military aid flows to 96 countries and his study revealed that foreign aid did not significantly increase investment and growth. His study further asserted that foreign

aid did not improve the lives of the poor, as indicated by human development indicators like infant mortality, but merely increased the size of the government or of consumption. This finding is also consistent with one of Burnside and Dollar's (2000) regression results, which found that bilateral aid had a strong positive impact on government consumption, and, as a result, no positive effect on growth.

3.3.2.2 Education, health and population

The assessment of the effectiveness of aid targeting education, health and population will be based on the performance of the Millennium Development Goals (MDGs), which have already been discussed in section 2.2.5.

A report released by the United Nations in 2015 provided the latest data on the progress made on the MDGs. The data shows that extensive progress has been made since 1990 to achieve the set goals. Summarised below is the current performance level of the goals, as published by the United Nations in 2015.

- LDC poverty levels dropped from 47 per cent to 14 per cent between 1990 and 2015 (UN, 2015);
- The enrolment rate in primary school education rose from 83 per cent to 91 per cent in Southern Asia, where previously, only 74 girls were enrolled in primary school for every 100 boys enrolled (UN, 2015);
- The under-five mortality rate dropped from 90 to 43 deaths per 1,000 live births. The maternal mortality ration declined by 45 per cent worldwide. New HIV infections fell by at least 40 per cent, whilst the malaria incidence rate has fallen by 37 per cent and the mortality rate by 58 per cent (UN, 2015);
- Access to drinking water increased from 76 per cent to 91 per cent for the global population, compared to 76 per cent in 1990. 95 countries have met their sanitation target; 98per cent of ozone-depleting substances had been eliminated since 1990 (UN, 2015); and
- ODA increased by 66 per cent in real terms reaching 135.2 billion (UN, 2015).

Using the above data as evidence, it can clearly be seen that substantial progress had been made towards the MDG targets, indicating that foreign aid had the desired effect on the MDGs. In the same report acknowledgement was made by the UN that despite the evident successes, progress has not been consistent across the regions and countries, with still so many people living in poor conditions.

However, Attaran (2005) questioned the validity of these reports, questioning the reliability of the data used to come up with these results. Attaran (2005) argued that each of these goals are clearly stipulated, but often unable to measure the indicators as the baseline before the MDGs is not known and therefore one is unable to track whether the trend of improvement is actually occurring.

3.3.2.3 Economic infrastructure

Another key variable required for sustainable economic growth is infrastructure, be in the form of transportation, institutions and communications. Serven (2010) stated that infrastructure had the ability to affect aggregate output and thereof economic growth, in two main ways: firstly, a direct impact as infrastructure services enhance the production function; secondly, it has the ability to reduce transaction costs within the production function.

Radelet et al. (2004) assessed the aid-growth relationship through infrastructure by conducting a study of 67 countries in respect of the period 1974 and 2001. Their analysis excluded emergency aid and all types of aid that was aimed at economic growth indirectly through either environmental degradation or health and education. This type of aid was excluded because they believed it gives misleading results. For example, in the case of emergency or humanitarian aid, a negative finding might not have been induced by foreign aid, but by the disasters that have occurred. Similarly, aid targeting factors like health and education will only exhibit their effect after a number of years. Their study focused on foreign aid that aimed at short-term growth, for example, aid targeting infrastructure or aid to support budget or balance of payments. The analysis revealed a strong and positive impact on economic growth, but with diminishing returns. The study also showed that the level of growth is significant in countries with stronger institutions. They further asserts that even though there is a positive correlation between foreign aid and growth, it does not imply that ODA has worked or will work everywhere, but rather that short-term assistance tends to yield a positive impact on development.

### 3.3.4 Exchange rate and taxes

Riddell (2008) researched the impact of foreign aid on taxes and exchange rates. His researched revealed that foreign aid focusing on taxes only led to a phenomenon called fungibility of aid, which simply means that governments sees the extra revenue as an opportunity to over-spend and finance a range of projects and programmes that do not significantly contribute to the overall development of the country. He further argued that his

evidence supports the view that recipient countries should drive the process, as they will be better able to identify what exactly the funding should target.

Leiderer (2012) also agreed with Riddell (2012) by further stating that foreign aid targeting budgeting support is fungible money and likely to end up being used by corrupt government employees or unwarranted tax payers.

It was also seen that aid that focused on exchange rate induced a phenomenon called Dutch Disease effect. Dutch disease effect is when the exchange rate strengthens whilst the relative competitiveness of the economy declines, affecting export expansion and decreasing the potential for further wealth creation (Riddell, 2008). This finding was confirmed by Younger (1992) (cited in Riddell, 2008), who conducted a study on the impact of massive aid inflows into Ghana, and concluded that aid flows hurt the Ghanaian economy, instead of helping it. The study stated that the rise in aid flows gave rise to high inflation, an appreciation of the real exchange rate and tight credit to the non-bank private sector, proving that foreign aid caused the Dutch disease phenomenon in Ghana (Riddell, 2008)

### 3.3.5 Programme assistance

Riddell (2008) conducted various studies to understand the impact of aid that targeted specific programs, projects or technical assistance. These projects were either funded through government or NGOs. In all cases, his findings showed a combined result, where foreign aid worked in certain cases, but not in others.

Riddell (2008) found that a project level there was a success rate of about 70 to 80 per cent with all official aid spent on projects. These involved projects or programmes aimed at delivering specific tangible and intangible outputs targeting certain sectors, for example, schools, roads, medicines, textbooks, water tanks. However, he went on to state that the evidence showed that project performance varied and was not consistent across different sectors and countries.

Riddell (2008) then went on to review the performance of aid aimed at technical support and capacity development where he found that out of 1689 technical assistance projects evaluated, only 29 per cent had a substantial impact on institutional development, with a further 45 per cent having a modest impact. However, a few successes were recorded in the South African national treasury and Tanzanian national bureau. He stated that various reasons attributed to this poor performance of aid targeted at technical assistance and

capacity development. Firstly, the cost of providing it was very high and therefore less impact. Secondly, multi-tasking on the part of the personnel assigned to the country and therefore unable to focus on the main objective of transference of the necessary skill. Thirdly, the provision of skills that are not needed. These are some of the reasons that have motivated the growing need that the process should be owned and led by the recipient countries, as they will then be able to clearly articulate their real needs and how to address them (Riddell, 2008).

Riddell (2008) further assessed the impact of foreign aid that targeted projects managed by NGOs, and found that 90 per cent of NGO projects were successful in achieving their immediate objectives and have had the desired impact. However, Riddell (2008) questioned their sustainability and the continued effects of the aid. He also cautioned that even though the NGOs had the desired impact, his studies were unable to quantify the level of this impact, as he believed it was not sufficient. However, Lewis (2001) has questioned the importance of NGOs. He believes that aid funded by NGOs has no impact on the lives of the recipients, as NGOs are not transparent in what they do, their views represent no-one but themselves, and the overall contribution to reducing poverty remains small and largely unproven.

### 3.3.6 Review of the impact of foreign aid on economic growth

Having presented the case studies on other indirect variables, what is the literature saying about the overall impact of aid on economic growth? A comprehensive study called the Growth Project which comprised of the African Economic Research Consortium, Harvard University, and Oxford University, was conducted and produced the first ever assessment on the economic growth of the sub-Saharan Africa from 1960 to 2000 (Ndulu and O'Connell, 2004). Even though the study is not directly linked to foreign aid, one is able to infer that foreign aid had an influence on growth both positively and negatively, as aid was a major contributor to government's budget in the same period. Outlined below are the main findings of their study:

- Human development indicators showed an improvement over the 40-year period, and real GDP per capita rose by 60 per cent (Ndulu and O'Connell, 2004);
- However, further analysis indicated that non-African countries grew more than African countries after 1960, with a fall in real incomes of over 35 per cent in relation to other countries (Ndulu and O'Connell, 2004); and

- A rise in income inequality and a rise in poverty with nearly half of the sub-Saharan African population falling below the income poverty line of $1.50 per day was found. In contrast, there was a fall in the global incidence of poverty: from 20 per cent to 7 per cent. Why then did SSA countries did not follow the same trend? Ndulu and O'Connell (2004) provided a few reasons why Africa's growth fell short of that of the rest of the world, and these are the reasons that have also been echoed as to why foreign aid is ineffective. One is the low yield on investment made due to capital flight from the region driven by poor governance, an inefficient public sector, tax avoidance, and the rent-seeking and corrupt behaviour of government officials. These are factors that are not unfamiliar to the aid and growth debate (Ndulu and O'Connell, 2004).

## 3.4 Factors that influence empirical research on foreign aid

There is no doubt that ODA positively impacts growth in certain countries and communities. However, it is important to provide a contextual background as to why there has not been one conclusive answer regarding whether foreign aid is effective or not. Riddell (2008) believes that there are certain factors in the research process that have led to the inability of academics to conclusively state that foreign aid is effective and the failure to quieten the ongoing debates. Riddell (2008) highlights the following as being the main reasons:

- Firstly, Riddell (2008) stated that there is no clarity as to what levels of poverty and inequality are acceptable. Is foreign aid meant to eradicate or close all the gaps of inequality? Or should aid be judged in relation to the outputs of the project or expected outcome? Pearson's (1969, cited in Riddell, 2008) point of view is that aid is not meant to close all gaps and eliminate all inequality, as that would be impossible; rather, it is to reduce disparities and remove inequalities. Riddell (2008) further stated that the main aim of foreign aid was to help poor countries to move forward into a more sustainable economic age and to give them a push into the industrial and technological age. However, Wangwe (2006) believes that, in the long run, foreign aid should go beyond filling in the gaps and move towards a more sustainable closure of the gaps. This lack of clarity has led to very biased and subjective conclusions when it comes to measuring levels of poverty or even concluding that foreign aid is indeed effective;
- Secondly, the problem of data integrity made it impossible for studies to present a statistically accurate or exact picture of the impact of foreign aid on growth. These included double or under-counting, significant gaps in terms of coverage, reliability, consistency, uncertainties and lack of baseline data (Riddell, 2008). For example,

one study in Latin America found that the number of people living in poverty ranged from 17per cent to 77 per cent depending upon how poverty was defined (Riddell, 2008). Another example came from Radelet et al. (2004), who left out humanitarian aid in their study stating that this type of aid does not target economic growth and therefore creates room for misrepresentation when it is measured for growth impact;

- Thirdly, time lapses were not taken into account when the studies were conducted. In certain cases, the impact can only be seen or felt after a period of two to three years and absence of proper monitoring projects over this period of time is often lacking (Riddell, 2008). Radelet et al. (2004) goes on to support this view by giving an example of the education and health sector, stating that the impact of foreign aid may only be felt decades later. This raises the question when measuring the effect of aid on growth, as to whether it should be concluded as being successful or unsuccessful immediately after implementation and before the results have been realised (Riddell 2008); and
- The last factor was the existing confusion over what trends, impacts and variables are to be measured in assessing the impact of foreign aid. Riddell (2008) stated that, donors, as well as those assessing the impact of aid, need to know what constitutes the main ingredients and the constraining factors in terms of growth and development. Once these are clearly defined it is easy to measure these variables directly to assess the impact. Radelet et al. (2004) pointed out that some of the criticism levelled against the effectiveness of aid was uncalled for, as a significant amount of aid was not aimed directly at achieving economic growth, so to measure that type of foreign aid against economic growth was misguided. They argued that foreign aid aimed at supporting democracy or humanitarian relief efforts was not primarily aimed at stimulating growth, it would, therefore, be surprising if much of this aid had a positive relationship with growth.

Despite these drawbacks, studies of foreign aid effectiveness are ongoing, with each one focusing on different variables in a quest to prove or disapprove whether aid is indeed effective and, more importantly, to determine how to make it work.

## 3.5 Current constraints to foreign aid effectiveness

The belief that foreign aid works has led to emphasis being placed on how to make it work for all recipients. Lessons learned from other studies have unearthed a number of factors that are believed to affect the performance of foreign aid negatively. The quest is now on to understand these factors and what could be done to minimise them and enhance those that

have been working well. One of the known commentators for foreign aid, Riddell (2008) conducted a comprehensive study of the common constraints to foreign aid. He categorised his findings into two main categories: donor-led factors and recipient-led factors. As the name suggests, certain factors are triggered from both the donors' side and the recipients' side. These constraints are summarised in the section below.

### 3.5.1 Donor led constraints

Riddell (2008) believed that there were certain constraints to foreign aid that were triggered by the donors themselves. These are outlined below.

- Firstly, Riddell (2008) stated that foreign aid was volatile and unpredictable. Riddell (2008) argued that there was no consistency in the amount of foreign aid given and at times donors do not honour the financial commitments they have made. Riddell (2008) went on to state that the best estimates suggested that the total amount of ODA required to meet the development and emergency needs worldwide is more than three times the current amount being given. Riddell (2008) further criticised the current methods of allocating aid as not being based on any methodology, which should aim to match the needs with the aid funds provided. He believed that this could be influenced by commercial or political interests on aid decisions;
- Secondly, recipients have to deal with a number of donors and the ever-expanding numbers of projects and programmes leading to complexities that render aid ineffective (Riddell, 2008). Riddell (2008) highlights three key reasons why there is such complexity. Firstly, donors are often competing with each other to fund projects; secondly recipients are unable to adhere and conform to certain donor regulations and procedures and thirdly there is no effective regulatory framework for managing foreign aid;
- Thirdly, there is the phenomenon called aid and absorptive capacity, whereas the volume of aid increases, its marginal utility declines. Foreign aid has a diminishing utility aspect and reaches a point called absorptive capacity where providing more aid will just lead to inefficiencies (Riddell 2008). Collier and Hoeffler (2002) also conducted a study to assess the impact of aid on absorptive capacity for aid in twenty-seven countries and found that absorptive capacity hugely depended on their current level of their policies and institutions;
- The fourth factor is the foreign aid tie conditionality, i.e. donors require that foreign aid donated only be used to purchase goods and services originating in the donor country (Riddell, 2008). This has pushed up the cost of aid by over 20 per cent (Riddell, 2008). In addition to procurement most donors offer economic advice which

has, in most cases, been viewed as an impediment to better aid impact (Riddell, 2008). In contrast, Burnside and Dollar (2000) argued that certain conditions need to be followed for aid to work and in cases where aid conditions were prescribed, but not followed, foreign aid failed to achieve its objectives. Of course this view has been disputed by Hansen and Tarp (2000), who stated in their study that aid worked even in instances where poor policies were being pursued. Riddell (2008) believes that conditionality is important, however, each country's case must be viewed individually and there should not be a blanket policy for all recipients. By the end of the 1980s, the World Bank agreed that, as an instrument to promote aid reform, conditionality had failed, but this admission did not stop condition-based aid being used as an instrument (Devarajan, 2001); and

- Lastly, Riddell (2008) also states that although aid agencies have affirmed their intention to make aid effective time and again, their internal processes, reward and incentive mechanisms for their staff are not aligned or does not enable foreign aid effectiveness. This has resulted in non-commitment of those who manage and oversee aid programmes ultimately affecting the end result of aid effectiveness.

### 3.5.2 Recipient led constraints

There are various constraining factors that Riddell (2008) states are driven from the recipient's side. Below is a summary of these constraints.

- Firstly, the effectiveness of aid relies heavily on the recipient's political structure, processes of the country, unrests and conflicts. Riddell (2008) highlighted that in most countries aid was ineffective when these factors were either not present or unfavourable. Booth (2005, cited in Riddell, 2008) confirms this factor by asserting that the main contributing factor to Africa's governance problems is in the nature of its political, economic and administrative systems. Efforts to improve Africa's governance structures have proven to be difficult, as there is no consensus amongst donors as to what the right definition of governance is and how to improve it (Riddell, 2008);
- Secondly, it is important that the recipient countries own and are committed to the poverty alleviation strategy for aid to be effective. This ensures that the funds given will be used for the intended purpose. In most cases there is lack of ownership and hence unable to achieve the set objectives (Riddell, 2008);
- Thirdly most recipients' governments are corrupt and misuse the donor funds rendering aid ineffective (Riddell, 2008);

- Fourthly, there are certain countries termed "low income countries under stress" that have deep seated challenges that even foreign aid will not have any impact at all until these challenges are dealt with (Riddell, 2008); and
- Riddell (2008) states that there are other wider context issues that affect the effectiveness of aid that cause stagnation and perpetuate poverty that may be influenced by external factors like movements in global prices, exchange rates, trade rules and regulations.

## 3.6 Foreign aid criticisms

The results of the studies and other assertions discussed above have led to various criticisms being levelled against foreign aid. This section highlights the common criticisms why aid is viewed negatively thereby calling for an end to it. Moyo (2009) argues that at time that aid was at its peak between 1970 and 1998, poverty in Africa rose from 11 per cent to 66 per cent. Moyo (2009) then questioned, that if foreign aid is meant to reduce poverty then why was poverty on the increase? She goes on to state that there is no doubt that there are other factors that have contributed to the current state of Africa's economy, for example, geographical, historical, cultural, tribal and institutional; however, all these factors are dependent on aid.

Radelet et al. (2004) also criticised foreign aid, in that it encouraged corruption and does not incentivise private sector to improve productivity. They further state that it causes currency appreciation and undermines the profitability of all tradable goods, a phenomenon called Dutch Disease. They argue that agri-based economies are hurt by a reduction in reduced farmer income, as a result of lower food prices (Radelet et al., 2004).

The very definition of foreign aid has been criticised as being the cause of confusion when it comes to aid allocation (Riddell, 2008; Tandon, 2008). Riddell (2008) believed that the definitions of aid have been narrowly and restrictively defined by those who have an interest in particular forms of aid. Confusion exists between definition of development aid and foreign aid. This has led to inaccurate calculation of how much aid is needed for African countries. Riddell (2008) suggest that foreign aid should be defined with those receiving it in mind and its main objective.

The MDGs have also been criticised as simply being a repetition of the foreign aid objectives used in the past 40 years (Riddell, 2008). Riddell (2008) continues to state that they did not

seem to lead to a clear and coordinated international response, were expensive, and were time consuming to organise and run.

Another common criticism has been made towards the poverty reduction strategies, Riddell (2008) states that many of these strategies have been criticised as being externally driven and, in some cases, externally written. This results in the recipient government neither owning the process nor being accountable for the strategy implementation.

Lastly, the world of foreign aid is not a single unified system making it difficult for the recipient government to interact and comply with the different donor requirements (Riddell, 2008). Riddell (2008) states that on average a recipient country received aid from 26 different official donors. This doesn't necessarily mean more aid, but rather allocating more resources to oversee the projects and programmes. For example, the Ministry of Health in Mozambique recently had a portfolio of more than 400 official donor projects; Tanzania had a portfolio of more than 2000 donor projects; donor missions to visit these projects is also time consuming, for example in the case of two countries over 400 donor missions took place that means its more than one visit a day (Riddell, 2008).

Having criticised foreign aid, Riddell (2008) goes on to criticise the foreign aid pessimists. He states that it is important for them to show concrete evidence of the negative effects of aid, rather than stating the consequences of aid, as the detrimental outcomes may have been caused by factors other than the aid itself (Riddell, 2008).

## 3.7 Proposed foreign aid reforms

In his discussions, Riddell (2008) recommends a number of changes that if implemented correctly may contribute to aid being effective.

- Firstly, Riddell (2008) suggests that aid focussed on short-term needs had a high success rate (between 75 per cent and 90 per cent). For example, in cases where it was used to provide tangible goods directly (like medicines, bed nets, seeds to plant, improved water supplies to prevent cholera), foreign aid has been effective. He therefore recommends that aid should be used to address these specific and short-term needs.
- Secondly, Riddell (2008) recommends that a new way of managing the different foreign aid relationships is required to reduce the complexity, duplication and

competitiveness. He proposes that the following governance structures should be enacted:

  - An international aid office (IAO) for development aid should be established with its main responsibility including the overseeing and ensuring the effective functioning of a new international development fund for the poorest countries;
  - A new international development aid fund for the poorest countries should be set up and the amount raised for this fund should equal the exact amount required by these poor states; and
  - National Aid Implementation Agencies (NAIAs) should be set up. Their role would be to act as another unofficial bank for foreign aid. If the IAO is satisfied that a qualifying poor country met the required criteria to receive aid, it will allocate the funds directly to the government, but if the country does not qualify, the funds should be given to the NAIAs, until such time as the country has complied. This would ensure that the money is allocated, but only spent when the countries have complied with the required criteria.

- Thirdly, Riddell (2008) further proposes two approaches to foreign aid management. First is the discrete individual donor approach, which involves each donor agency focusing narrowly on its own aid programme, and making its own mind on how to improve the effectiveness of its own funds. The second approach is the step-change international cooperative approach which simply encourages greater coordination among donors. This approach has seen the set-up of joint aid programmes, pooling of funds together by donors, undertaking joint programmes, aligning aid more closely with developing country's plans and strategies; and
- Lastly, Riddell (2008) believes that there should be less political influence on the way official aid operates. For instance, at the 2006 spring meetings of the IMF and the World Bank, the British finance minister, Gordon Brown, made a path-breaking plea for the operational work of the IMF to be made independent of political to make its work more credible, authoritative and effective (Riddell, 2008).

## 3.8 Conclusion

This chapter of the study aimed to provide insight on the current state of foreign aid by analysing the current foreign aid flows and trends, as well as reviewing case studies on the effectiveness of foreign aid.

First, the current foreign aid indicators were reviewed and analysed. The analysis showed that foreign aid flows are still on the increase, with the USA still being the main aid donor, and the UK finally reaching its target of 0.7 of its GNI. The data further showed that 2013 was the highest increase in foreign aid ever recorded of a 6.1 per cent, and predicted to continue rising for the next three years at a rate of 2 per cent. Sub-Saharan Africa remains the largest recipient of foreign aid; however, it is predicted that foreign aid to this region is set to decline in the next three years. On a more positive outlook dependency levels have declined by a third in the past 10 years.

The chapter also reviews what the current literature is saying on the effectiveness of aid. The discussion was based on an analytical framework that focused on the transmission process that foreign aid undergoes. Briefly, the framework highlighted that foreign aid is injected into a country to supplement the savings gap, so as to boost investment levels. The funds are usually transmitted through various economic variables, these being infrastructure, education, health and population, exchange rates and production. Case studies focusing on these variables were then reviewed. These revealed conflicting results, either that aid had a positive or negative effect on the specific variable under study. Out of these 17 case studies, 13 case studies found a positive relationship between foreign aid and development. Evidence reviewed showed that foreign aid contributed positively and tangibly by closed the savings gap, imparting skills, improving the quality of services, developing and improving the physical infrastructure, contributed to improvements in production, and provision of school books and bed nets, drugs for inoculations and basic medicines (Riddell, 2008). The studies also showed that good institutions, policies, climatic conditions and democracy were all a prerequisite to ensuring that foreign aid had the desired impact on economic growth. However, most of these results have not been sustainable and in the majority of cases the positive outcome depended on certain conditions being favourable (Riddell, 2008). Riddell (2008) believes that for aid to be truly effective it has to be sustainable, and that is where the true effectiveness of aid will be tested and is up until today lacking in most LDCs.

The other case studies found a negative correlation, and their findings showed that foreign aid negatively impacted economic growth by importing inappropriate technology, distorting domestic income distribution, encouraged bigger, inefficient and corrupt government. Foreign aid also led to decreased levels of countries' democratic dispensation. The reliability of the Harrod and Domar model (1946) was questioned by Griffin (1970) in which he showed that aid led to reduction of domestic savings and not closing the savings gap.

This chapter has given a brief picture of the current state of foreign aid. It has showed that foreign aid is still an important part of most government's budget and is set to increase. The current discussions or case studies on aid effectiveness were also discussed, with no one over-arching stance on whether foreign aid works or not. What then is the correct answer to aid effectiveness? Riddell (2008) states that there is no simple yes or no answer as to whether aid works or not. He goes on to say that the overall evidence and data on aid impact still remains partial and of poor quality, making it difficult to defend a firm and over-arching decision on the impact of aid. This uncertainty and the difficulty of assessing the impact of foreign aid, has left the discourse on foreign aid impact open to bias, distortion and even propaganda or even a little more than a game of chasing shadows (Riddell, 2008).

Easterly (2007) also puts forward a simple question "Was development assistance a mistake?" His answer is 'yes'. He argues that development assistance was a mistake, as most policy makers do not understand what factors are needed to achieve development and the implementation of the proposed policies that they have implemented have failed over time. He goes on to say that this does not mean that foreign aid should be eliminated, but rather that it should be used to finance specific projects in piecemeal steps.

There is no doubt that foreign aid has weaknesses that limit the potential impact of aid on LDCs, and if these are addressed appropriately, aid would have the impact that is expected (Riddell, 2008). However, it would be mistaken to state outright that aid doesn't work, and therefore should be stopped (Riddell, 2008). It is also interesting to note that some studies have found a significant negative correlation between aid and growth, but do not call for an end to aid, but rather for further investigation into how to ensure aid works (Djankov et al., 2006).

Development is indeed a complex process, which is difficult to define, and difficult for outsiders to help in promoting without an in-depth understanding of the attributes and constraints of each poor country (Riddell, 2008). Foreign aid often contributes to this development, but it is neither a crucial ingredient nor does it mean that it is not important (Riddell, 2008).

If foreign aid is still regarded as a vital element for economic growth, is there any merit in the theories that call for an end to foreign aid? The next chapter will aim to answer this question by looking at the different recommendations that have been proposed towards a foreign aid free economy and whether these do justify the end to foreign aid.

# CHAPTER 4

# PROPOSED FOREIGN AID EXIT STRATEGIES

## 4.1 Introduction

Despite the ongoing debates on the effectiveness of aid, various economists, still believe abolishing aid or cutting back on aid would be a mistake and is not warranted by any reasonable interpretation of the evidence (Tarp, 2009; Riddell, 2008). However, other economists have disagreed with this view and have gone ahead and proposed exit strategies on how aid dependent economies can reduce and eventually end their dependence on development assistance. Such prominent economists are, Dambisa Moyo (2009), Yash Tandon (2008) and Derek Fee (2012). The central argument of these three authors was that foreign aid had failed to achieve its main objective, and that the least developed countries (LDCs) should look for another alternative source of funding for their development initiatives. An outline of the common aid criticisms have been highlighted in section 3.6. In addition, criticism by Moyo (2009), Tandon (2008) and Fee (2012) have been outlined in the section below. Based on this shared common view, each of these authors offered a list of strategies and frameworks through which, if implemented well, LDCs could liberate themselves from aid dependence. In their recommendations, all three authors included the need for foreign aid, indicating that it was not an immediate exit from aid they were recommending, but rather a gradual reduction in aid, with the aim of eventually ending aid dependency. In this instance foreign aid exit is defined as process through which a development partner withdraws its bilateral development cooperation after having agreed with the recipient country (The Danish Department of Quality Assurance and Financial Management, 2014)

It is against this backdrop that this chapter will outline these proposed exit strategies, with the aim of assessing whether they are feasible and a panacea to ending foreign aid in LDCs. This chapter is made up of four key sections, consisting of the following: sections 4.2 highlights the proposed exit strategies from the three authors under review. The discussion commences with the main argument from each author, followed by their criticism of foreign aid, ending with their recommended solutions on how to end LDCs reliance on foreign aid. Even though the main goal for all the three authors was to reduce dependency on aid, they had different ways of achieving that end, these differences and similarities where appropriate are discussed in section 4.3. Not surprisingly, these exit strategies have had their fair share

of criticism, these have been highlighted in section 4.4. The chapter concludes with a summary of the main points and views discussed in this chapter.

## 4.2 Outline of proposed exit strategies

### 4.2.1 Brief outline of ending aid dependence: Yash Tandon's proposed exit strategies

4.2.1.1 Main argument

Is aid what it says it is? This is a thought-provoking question raised by Tandon (2008) at the beginning of his book, and the answer to the question formed the basis of his argument. Tandon (2008) argued that despite its positive primary goal, foreign aid has failed to deliver what it had promised. He further asserted that the foreign aid world is full of questions and solutions that have not promoted development, but have rather perpetuated aid dependence. Against this backdrop, the main objective of his book was to provide recommendations to aid dependent economies on how to reduce and eventually exit from aid. His recommendations were embedded in a seven-step strategy, which consisted of: adjusting the mind-set, budgeting for the poor, not for the donors; making employment and decent wages a priority; creating a domestic market and owning domestic resources; plugging the resource gap; creating institutions for investing national savings; and limiting aid to national democratic priorities. Underlying these strategies was the proposal he made for countries to not only reduce aid, but to also embark on nationalistic projects, which he hoped would transform these nations as a whole. The National Project simply meant finding a way to exit aid dependence, by placing developing countries on the road to national and regional self-reliance, which is a continuation of the struggle for independence, proper use and management of its own natural resources (Tandon, 2008).

4.2.1.2 Tandon's criticisms of foreign aid

Tandon (2008), painted an image of how foreign aid had failed to lift LDCs out of poverty for the past 50 years. In his discussion, he highlighted six main areas where aid had failed. These are outlined below.

- The dominant criticism that Tandon (2008) had against foreign aid was the definition of aid itself. He argued that foreign aid was defined from the donor's point of view, including and excluding certain categories which he believed should have been included as it made foreign aid very elusive, for example, why was military aid excluded as part of foreign aid, why administration costs were included as ODA. He

proposed that aid should be defined based on the need being addressed through a system of governance that is democratic and accountable to its citizens and not to foreign donors;

- Secondly, he criticised the donors' inability to keep their promise of donating the agreed target of 0.7 per cent of GNI, as agreed by the DAC members. He stated that the 0.7 per cent was the most important measurement of the donor's commitment to the development of LDCs, which most of them have failed. For example, the United Kingdom only met its 0.7 per cent target in 2013, 55 years later;
- Thirdly, in terms of accountability, he questioned who the government was accountable to, is it the donors or its citizens? In most cases, governments are accountable to donors rather than the country's citizens as they are the ones financing them;
- Debt Burden was the fourth factor he criticised. He stated that most African countries were left with huge debts to service, as a result of foreign aid;
- Much of the aid was tied to procuring goods from donors, which caused the price of these goods to increase by 25 per cent to 60 per cent (United nations, 2008, cited in Tandon, 2008: 34; and
- Lastly, he questioned the credibility of the DAC statistics, which only captured flows from donors to the poorer countries; but there is no similar data indicating outflows, in the form of debt repayments, from the developing nations to the developed countries, which in some cases exceeds the aid inflows. He further asserted that DAC is its own collective judge and jury, that there is no outside independent body that monitors and checks the accuracy of figures and reports produced by the donors. No-one questioned or monitored whether the promised donations have been made or not; or even the figures presented any real value (Tandon, 2008).

These were the core criticisms of foreign aid that were highlighted by Tandon (2008). With these in mind, Tandon (2008) outlined a seven-step strategy that aimed to assist the LDCs reduce their dependence on foreign aid. These strategies are discussed in the section below.

4.2.1.3 Tandon's proposed exit strategies

Tandon's (2008) exit strategies were categorised into seven categories, which are discussed below.

**Proposed strategy 1: adjusting the mind set**

Tandon (2008) advocated that the first place to start with reducing aid was the adjusting of the mindset, where the psychology of dependence had been fostered and fed by the long relationships with the donors. He proposed that the process should start by engaging the citizens in discussions on the best way to get out of the trap of aid, after which the process involved political parties, social groups of all ages and gender, and this should be done without the interference of the donors. He called this process "the will to take the destiny of the nation into one's own hands" (Tandon, 2008: 248). The importance of adjusting the mind-set was also raised by Moyo (2009), where she stated that one of the key factors that have attributed to Africa's poor economic growth is its cultural beliefs, mentality and physical ability. Moyo (2009: 31) elaborated, "Deeply embedded in their psyche is the inability to embrace development and improve their own lot in life without foreign guidance and help". Again, a similar view of the importance of the mind was heard from Biko (1977), when he stressed the importance of the mind, saying that the most potent weapon in the hands of the oppressor is the mind of the oppressed. Change of mind-set is the radical change required to unlock the trap of foreign aid, and for LDCs to implement the exit strategies being proposed."

**Proposed strategy 2: budgeting for the poor and not for the donors**

The second strategy proposed focused on changing the budgeting process, which was driven from the donor's perspective, and mainly aimed to meet the needs of the donors rather than its own citizens. Tandon (2008) proposed a budgeting process that would ensure that all levels of society, from grass roots level right up to the top, were consulted, as each had a key role to play in the definition process.

**Proposed strategy 3: putting employment and decent wages upfront**

The main economic driver of most LDCs is the agricultural sector, unfortunately this sector is unable to absorb the high unemployment rates due to its slow growth. Growth in this sector may be accelerated through structural changes to the agricultural sector, namely, increased capital accumulation, technological learning and innovation. Over time, the growth of the economy will absorb the unemployed and, over time, bridge the gap between the rich and the poor, through decent wages (Tandon, 2008).

**Proposed strategy 4: creating the domestic market and owning domestic resources**

The fourth step Tandon (2008) proposed was the creation of the domestic market first before opening it up to international markets. He argued that export-led strategies distorted development priorities, as resources were diverted away from the basic needs of the citizens, and wrong skill sets were created which opened up the economy to international

trade hazards capital movements and donor interference. Contrarily, a domestic demand-led strategy would lead to a number of benefits, namely: the production of essential foods and consumer goods, land ownership, tariffs would be managed by its own citizens, an ideal wage system, and favourable pricing for farmers.

**Proposed strategy 5: plugging the resource gap**

In his fifth proposal, Tandon (2008) questioned the fundamental objective of foreign aid, which aimed to close the savings gap for the LDCs. Instead of foreign aid being used as a mechanism to close the savings gap, Tandon (2008) proposed the reduction of externalised expenditure, which was caused (in most cases) by either war or transfer pricing done by multi-nationals.

**Proposed strategy 6: creating institutions for investing national savings**

Another fundamental strategy that he proposed was for governments to create supporting institutions and structures that will ensure that the national savings are properly invested. Three key role players were identified in this process, namely, the state, the private sector and the community. He promoted the role of the state and the community, so as to create a balance between the three key role players to boost national savings. The state's role would be to collect tax and tariffs to enable it to provide public goods, development a strong central bank and building the nation's knowledge and research capacity. The community should focus on growing its informal sector, with the support of the government, as this is where the bulk of the needs of the population are met.

**Proposed strategy 7: limiting aid to national democratic priorities**

Despite this, Tandon (2008) still believed that aid had a role to play, but its role had to be defined in its proper context only by the citizens through their own democratic processes. He recommended that aid should be limited to the following categories: Green/Blue Aid (grants, debt relief, humanitarian and emergency), Purple Aid (aimed at issues of solidarity) and Yellow Aid (mainly military). Red aid (which supported certain ideologies), and Orange Aid (which was mainly commercial loans and tied aid) should be stopped (Tandon, 2008).

4.2.1.4. Further recommendations on the structure of foreign aid

Tandon (2008) gave further recommendations on how the foreign aid organisations should be structured, in order for foreign aid to be effective:

- The OECD: Over time, the role of the OECD will become redundant and he recommends that the functionality of the OECD should be incorporated into the recipient's internal structures that they will create to coordinate foreign aid;
- The World Bank: He proposed that the World Bank could play a role in funding climate change initiatives required to move to a low carbon economy. These initiatives could include mitigation, adaptation, risk management and risk insurance, technology development and capacity building;
- The IMF: He recommended that the IMF should be redesigned into a coordinating institution. He further recommended that all of the current functions of the IMF should be regionalised at the continent level where regional credit institutions should be created to address the needs of the regional countries; and
- The Development Cooperation Forum (DCF): He proposed that the DCF should take a more active role and take over as an alternative to the OECD-DAC World Bank duopoly.

Outlined above are the recommendations given by Tandon (2008) on how to reduce aid dependency; however, the feasibility of these strategies is yet to be proven. Section 4.3 provides a critical analysis on whether these strategies are feasible or not.

### 4.2.2 Brief outline of dead aid: Dambisa Moyo's proposed exit strategies

#### 4.2.2.1 Main argument

Moyo (2009) always wondered why Africa has not managed to turn a corner towards economic prosperity, whilst other continents have done so. Her main argument is that foreign aid made the poor poorer and slowed economic growth. Evidence showed that at a time that aid flows were at their peak, between 1970 and 1998, poverty in Africa rose from 11 per cent to 66 per cent (Moyo, 2009). The purpose of Moyo's book was to offer a different perspective on why LDCs are still under development and how they might boost their economic growth. Moyo (2009) proposed an alternative financing model for the world's poorest countries, one that will ensure that there is sustainable economic growth and does not depend on foreign aid. This could be achieved through a five to ten year exit plan, whereby development finance should be raised through the following pro free-market initiatives: involvement in the bond market, free trade, foreign direct investment and tax reformation, less taxing of remittances and the development of micro-finance institutions (Moyo, 2009).

The discussion below will commence by first highlighting the ills that foreign aid has done, according to Moyo (2009). This will be followed by recommendations on how LDCs can exit foreign aid.

#### 4.2.2.2. Moyo's criticisms of foreign aid

Moyo (2009) cited a number of criticisms against foreign aid. These are discussed below.

- Firstly, she criticised the adoption of the Marshall Plan as a blueprint for Africa's economic development. Foreign aid was based on the success of the Marshall Plan; however, the notion that the same blueprint would work for Africa was simply wrong, as the two continents required different development needs and a different focus. The Marshall Plan had a time frame of five years, whilst aid has been in Africa for the past 50 years;
- Secondly, she criticised tied aid, i.e. the imposition of certain rules and regulations for aid to be given. Her argument is supported by Svensson (2000, cited in Moyo, 2009), who found no link between adherence to aid conditionalities and the rate at which the disbursement of aid funds occurred, further indicating that aid conditionality had an agenda other than ensuring that aid works;
- Thirdly, she questioned the promotion of democracy for African states, stating that democracy at the early stages of development could hamper economic growth. She believed that what Africa needs is a rather decisive dictator who will push through economic reforms that will benefit their economies;
- Fourthly, she believed that there were other driving forces behind aid, other than LDC economic development: the livelihood of people working for these organisations was at risk, that is, if aid were to end, they would lose their jobs; and
- Lastly, she highlighted other commonly heard criticisms, namely: that aid fostered corruption; that it interfered with the rule of law and stifled domestic and foreign investment; and, most importantly, that donor fatigue was slowly rising.

In conclusion, Moyo (2009) wonders why foreign aid has continued to exist, despite its proven failure.

#### 4.2.2.3. Moyo's proposed exit strategies

Moyo (2009) proposed four main alternatives for financing the development agenda for Africa's economy, instead of aid. These recommendations were given under four main strands: capital solutions, bilateral and trade relations with China, improving and opening up

Africa's trade relations with other countries and lastly ensuring credit facilities for local entrepreneurs. Each of these solutions will be discussed below.

**Proposed strategy 1: capital solutions**

The first financing alternative that Moyo (2009) recommended was issuing of bonds on the capital markets. Bonds are usually issued to assist in financing infrastructure, education and health care programmes, and at times even the day to day running of government departments. On face value loans raised through foreign aid seems to have more favourable conditions than the bond market, so why would LDCs opt for raising money through capital markets? She argued: bonds would provide a certain level of credibility to attract private investors; a stronger bond market would lower the cost of borrowing. Most important at that time was that investors were looking at emerging markets as potential areas to invest and Africa matched all the criteria for a great investment market (Moyo, 2009).

However, there were certain considerations and risks that have to be taken into account when a country decides to issue bonds, namely, risk of contagion, default and credit rating mistakes. She further cautioned African countries that issuing bonds requires a strong commitment on the part of government, as poor management may result in far worse consequences than foreign aid ever would (Moyo, 2009).

**Proposed strategy 2: developing bilateral relations with China**

The second alternative that Moyo (2009) recommended was for LDCs to attract as much Foreign Direct Investment (FDI) as possible. She believed that Foreign Direct Investment (FDI) is one of the key contributing factors to economic growth. FDI had the ability to create jobs, assist in transfer of new technology, to help stimulate a country's capital markets, improve management know-how and to assist local companies to compete on the international market.

One of the key trade partnerships she recommended, that could promote FDI was with the Chinese government. Despite the many weaknesses that Africa has when it comes to attracting FDI, the Chinese have invested heavily in Africa in the past ten years, totalling S$30 billion. Most African leaders have viewed funding from the Chinese as being better than foreign, aid as there no interference and no questions asked by the Chinese. However, European donors have criticised China's involvement in Africa as having no clear social, environmental or political conditions. However, Moyo (2009) still believes this is the one relationship to be maximised by the LDCs.

**Proposed strategy 3: trade**

The third alternative that Moyo (2009) proposed was that Africa should get involved in global trade, as many countries have not capitalised on the benefits of trade. The benefits of trade cannot be over-emphasised, namely: trade contributes to growth by increasing the amount of actual goods and services that a country sells abroad and this drives up the productivity of the workforce; it creates employment and improved the trade balance; it lowers the price of consumer goods through greater imports; trade increases government revenue through taxes. In just under five years, African countries involved in trade made the equivalent of 50 per cent of the trillions of dollars they were given in aid in the past sixty years. She urged African leaders to embrace and pursue trade with both China, as well as with other countries like India and countries on the African continent itself. Moyo (2009) further advocated Africa forming one single unit, with one currency, removing trade barriers amongst themselves, and most importantly ensure that the appropriate infrastructure is in place for effective trade to take place.

**Proposed strategy 4: financial solutions for the unbankable**

Moyo (2009) believed that the unbankable sector of many LDCs had the potential to boost their economies. This was the group of citizens that did not have access to any credit facilities to take part in the country's productive sector. She believed that making finance easily accessible to that part of the economy that formal banks had been unable to access could be key to providing the economic boost that most LDCs needed. This could be achieved through micro-lending, remittances and savings. A typical micro-lending model that could be adopted is that of Grameen Bank of Bangladesh, as it is a resounding success, and now operating 100 per cent with no donor money. She urged African leaders to adopt a similar model, as micro-lending is yet to reach 5 per cent of Africa's poor. With regards to remittances, Moyo (2009) stated that, a 10 per cent increase in capital remittances may lead to a decrease of 3.5 per cent in poor people. Therefore, removal of all taxes that prohibits people sending money home was encouraged. Moyo (2009) cited statistics from a World Bank report which estimated that Africa could have raised as much as US$1–US$3 billion by reducing the cost of international migrant remittances (World Bank, 2006, cited in Moyo, 2009). On savings, she believed that Africa had untapped savings that were not in the formal banking sector due to the lack of proper banking facilities for the poor. These savings could provide the required funding, rather than obtaining it through foreign aid.

4.2.2.4. Implementation approach

Moyo (2009) went on to propose three key implementation steps on how to kick-start the aid exit process.

- Step 1: Develop an Economic Plan: The plan should stipulate how they will reduce reliance on foreign aid, for example, they could cut aid by 14 per cent every year for five years, in which case an alternative source of funding will have to be put in place;
- Step 2: Cut spending on non-essential items; and
- Step 3: The third and last step she encouraged governments to strengthen their institutions and increase accountability.

Key in the implementation process was the need to adapt her recommendations to suit a country's needs and environment. To successfully implement these strategies, she emphasised the need for African leaders to have the right level of consciousness, political will, innovation and honesty.

### 4.2.3 Outline of Derek Fee's proposed exit strategies

4.2.3.1 Main argument

Fee (2012) was no exception when he questioned why development aid still existed despite the call from both the recipients and the donors to end aid. However, Fee (2012) took a different angle from Moyo (2009) and Tandon (2008). He did not blame foreign aid as being the cause of Africa's problems, but rather argued that donor fatigue was creeping in and that Africa should be looking for other alternative sources of financing, as foreign aid would soon end. With this in mind, he proposed the following five financing alternative solutions: institutional development, domestic resource mobilisation, economic diversification, increased global funds and, lastly, self-help aid.

4.2.3.2 Fee's criticism of foreign aid

Even though Fee (2012) did not base his exit strategies on the failure of foreign aid, he still highlighted a few areas where aid has failed. These are outlined below.

- The first criticism he had against foreign aid was that of 'mission creep', which he defined in two ways. The first definition was based on its inability to achieve its objectives despite the trillion of dollars spent. Despite its failure, donors and NGOs have not stopped for pushing for more aid, 'hoping that it will be different this time and the change required will finally be attained'. Unfortunately, aid has failed to achieve the objectives and simply creeps forward. The second definition of mission creep was based on the changing goals and objectives of foreign aid. Initially, aid was meant to assist LDCs to establish their economies to enable them to provide at least basic services to its citizen. However, over time, this mission has transitioned to 'fighting against poverty'. This change of focus was a mistake on the donor's part,

and he believed that instead of keeping people out of poverty, aid has, ironically, kept people in poverty;

- The second criticism was that foreign aid lacked exit strategies from the recipient countries. Fee (2012) believed that an exit strategy was just as important and that the strategy documents and agreements should state how donors will exit recipient countries. This is what has led to aid dependency and donor fatigue; and
- The third criticism was what Fee (2012) termed a "symbiotic' relationship between the donors and the recipients. He explained that aid transitioned from being donor-driven to recipient-driven, which was an excellent move; however, it lacked a results-driven approach, where donors were judged based on how much money they have given, rather than on what has been achieved. One can see that this is still the case in 2016, when the OECD (2014) releases results on aid flows per donor, the focus is on what each donor has given, but not what those funds have achieved in the respective recipient countries (OECD, 2014). The same applied to the recipient countries, where the focus was on what he called 'the spend at all costs' bug, where governments look for any opportunity to spend money and do not focus on achieving the intended objective.

To provide context to his recommendations, Fee (2012) first conducted an assessment of the prevailing aid exit strategies being proposed by other economists. At that time, these strategies were being labelled the "magic bullet" to end foreign aid. Key in his assessment was the policy implications and recommendations made as to whether they were ideal for purposes of ending aid or not. The findings of his assessment are outlined in the section below.

4.2.3.3 Fee's assessment of the current foreign aid exit policies

Fee (2012) assessed the following policies on their ability to replace foreign aid as a source of funding for LDCs' development initiatives: domestic resource mobilisation, trade liberalisation, the BRICS, regional integration, micro-finance, remittances, NGOs and philanthropic institutions. Outlined below are his findings.

- Domestic resource mobilisation, which simply focused on the implementation of an efficient tax system. He believed that resource mobilisation, if properly managed, was an important element in assisting countries to reduce aid dependency, but not a sufficient tool to replace it. However, the introduction of land taxes, property taxes, direct taxes and indirect taxes could aid in an efficient tax system;

- Trade liberalisation is indeed a key ingredient to boost economic growth; however, Fee (2012), argued that it is not the magic bullet that will assist in the reduction of foreign aid, at least not in the short-term. LDCs lack the infrastructure and correct representation at global trade talks to effectively implement trade liberalisation as a policy. He recommended that trade facilitation processes should be part of every government's agenda and not of the international trade agreements. He further recommended that foreign aid focusing on trade liberalisation should be increased;
- The BRICS partnership funding model, which is an abbreviation for the following countries: Brazil, Russia, India, China and South Africa. Fee (2012) believed that these countries presented an attractive funding source that was different from the traditional aid model; however, they were not a panacea to end aid;
- Regional integration: Regional Integration Organisation (RIOs) played a great role in economic growth; however, Fee (2012) believed that its weaknesses far outweigh its benefits and therefore it is not an ideal alternative to end aid dependency on its own;
- Micro-finance: Fee (2012) assessed whether micro-finance was a good tool to replace foreign aid. He concluded that micro-finance was not the solution for an aid exit strategy because of its many challenges that they face. Fee (2012) believed micro-finance was merely a bubble that will burst at some point and therefore not a panacea to reducing aid dependency;
- Remittances: A study by International Fund for Agricultural Development (IFAD) suggests that more than 30 million workers work outside their countries and send home approximately $40 billion per year (IFAD, 2007, cited by Fee, 2012). In 2009 global remittances were estimated at $300 billion per year, three times more than foreign direct investment (UNCTAD 2008, cited by Fee, 2012). The above studies clearly show the importance and impact that remittances have on LDCs and the potential they have to be used as a source of finance. In his findings, Fee (2012) agreed that remittances are an important and growing resource for the poor and that they have the ability to change an individual's economic situation. However, he concluded that they do not have that capacity to contribute to the structural requirements, which are key to aid reduction at the macro level; and
- NGOs and Philanthropic Organisations: The last financial alternative that Fee (2012) assessed was the role that NGOs and Philanthropic organisations have played in the aid business and whether they provide a solution for an aid alternative model. The main purpose of the NGOs was to work with grassroots organisations that usually comprises of the poor and marginalised to assist in promoting bottom up democracy. However, this role seemed to have changed over the years. This led to the

conclusion that aid delivered through NGOs is no better than the traditional ways that ODA has been channelled through before, therefore not a panacea to improving aid effectiveness nor being an alternative funding model. Fee (2012) further argued that NGOs should revert back to their original mandate of being the voice of the poor, as it is only in that role that they seem to have made a difference.

4.2.3.4. Fee's proposed exit strategies

Having analysed the 'magic bullet' funding alternatives, Fee (2012) proposed the following strategies as having the potential and ability to end aid dependency: institutional development, domestic resource mobilisation, economic diversification, increased global funds and lastly self-help aid. At the core of his recommendations was institutional development because of its importance and impact it has on economic growth and aid reduction. He recommends that all of these strategies should be implemented together, as they are dependent on each other, but with more emphasis being placed on institutional development.

**Proposed strategy 1: institutional development**

Institutional development is the existence of national institutions that ensures proper governance and management of the state and its organs, to enable effective democratic processes. Institutional development is a prerequisite for a sustainable development and most importantly an end to aid dependency. Fee (2012) concluded that for development to take place institutional development should have reached a certain level of acceptability for it to effectively absorb aid. He lists the following criteria set up by the Worldwide Governance Index (WGI) that assessed whether countries' institutions are at an acceptable level:

- Voice and accountability in terms of democratic elections, freedom of speech, freedom of association and free media (WGI, 2012 cited by Fee, 2012);
- Stable political environment free from violence and terrorism (WGI,2012 cited by Fee, 2012);
- The level of government effectiveness measured by the quality of public services, the quality of civil servants and the degree of independence from political pressure (WGI, 2012, cited by Fee, 2012);
- Regulatory quality: the ability of the government to formulate, implement and manage sound policies that incentivise private sector development (WGI, 2012 cited by Fee, 2012); and
- Rule of law: the presence of a credible and trustworthy law enforcement system, i.e. a judicial system, policing and property rights (WGI, 2012 cited by Fee 2012).

- Control of corruption: the ability to manage corruption in a country (WGI, 2012 cited by Fee, 2012).

Fee (2012) accepted that most sub-Saharan countries have not yet reached the above level of governance, but will need to work towards these criteria should they want to reduce their dependency on aid.

**Proposed strategy 2: domestic resource mobilization**

Fee (2012) believed that domestic resource mobilisation is key in filling in the gap for foreign aid. Section 4.2.3.3 above has highlighted the different tax categories recommended for implementation. However, for this to be a fair system, it is important that there is accountability, transparent reporting on all budget allocations by the government and the tax system is equitable and more importantly is for the government to own the process. He did acknowledge that implementation of such a tax system has its challenges, and to aid governments in this transformation journey, Fee (2012) outlined a number of considerations that government should bear in mind when embarking on these projects. These are outlined below:

- Diversification of taxes is key, as reliance on one type of tax can be risky.
- Increase revenue through transitioning the informal sector so that it falls into the tax bracket. This could assist most African countries to increase their tax base, as recommended by the IMF;
- Resource rich countries should not tax incentives, as this does not work and it would be beneficial for them to belong to the Extractive Industries Transparency Initiative (EITI). The EITI will provide them a platform where they can exchange information with other countries on how best to achieve the highest benefit from resource extraction; and
- In terms of the administration of the tax authorities, an independent Autonomous Revenue Authority (ARA) should be established. ARAs are key in ensuring centralisation of tax collection, however, there a few hurdles that most countries encounter with ARAs. Firs is the capital investment required to set up such an establishment, which is out of reach of most LDCs. Secondly, these ARAs are not free from political interference, which, at times, inhibits the organisation from operating properly (Fee, 2012). The opposite it also true in cases where ARAs have complete autonomy, as some tend to abuse this autonomy (Fee, 2012).

**Proposed strategy 3: economic diversification**

The importance of economic diversification cannot be over-emphasised as a key aid reduction strategy. However, the current supporting structures and policies have not enabled most LDCs to benefit fully from globalisation and diversification, for example, the trade agreement reached at the Uruguay Round does not benefit most African countries. And the only way African economies can develop and attain economic diversification is to develop the agricultural sector and agro-food business, as most LDCs do not have resource-based economies. The agricultural sector is the industry that will push LDCs onto that development process by the creation of new industries and up skilling of people from informal sector to industrialised sector. The McKinney Global Institute (2010) estimated that the African agriculture sector could grow to $880 billion by 2030 (McKinsey Global Institute, 2010 cited by Fee, 2012).

Fee (2012) cited one of Tandon's exit strategies, namely a change of mind-set, as being key to enabling economic diversification. LDCs require a change of mind set within the cultural beliefs and norms when it comes to land allocation both from the tribal chiefs and the government. In addition, change of mind set on all agricultural policies, which seem to have favoured large farmer and not small farmers. A successful case study on the importance of mind set was on Rwanda, where the leadership had the right and determined mind set to improve the business climate in their country, and it was achieved. This shows that it is possible for economic diversification to assist in aid reduction if the government is committed to the cause (Fee, 2012).

**Proposed strategy 4: Global fund for infrastructure**

The fourth strategy proposed the adoption of the Global Fund model of aid allocation and management. Fee (2012) believed that The Global Fund has been very successful in mobilising donor funds targeted at fighting HIV/AIDS, TB and malaria and vaccination. The fund consists of a small central organisation that collects donations from individual donors, NGOs and other philanthropic organisations, and then dispersed through a tender process. The structure of the organisation is small, with a clear vision and mandate, supported by appropriate technology and skills and ongoing internal audits are conducted. The funds are given directly to the national health agencies who are then responsible for carrying out the project. There is no time wasted between meetings with donors and governments. Fee (2012) believed that a similar fund should be set up to tackle the infrastructure deficit in LDCs (roads, communications and power), as well as to assist the private sector to implement their projects.

**Proposed strategy 5: self-help aid**

Previous experience had shown that once the donors finished a project, for example, a road, the maintenance of it thereafter was almost non-existence, resulting in these projects falling apart. To ensure that recipients took ownership of these projects self-help aid was introduced. The self-help or matching concept is when the recipient puts up an equivalent amount of funding towards the project, as does the donor. This, Fee (2012) argued, would prepare governments to take over the funding of these projects when aid is withdrawn.

This section has outlined the different exit strategies that were proposed by Tandon (2008), Fee (2012) and Moyo (2009). However, in view of the current economic conditions in most LDCs, are these strategies feasible? In addition, there were key differences identified during the analysis of these strategies, despite having a common goal of aid reduction. The section below will aim to answer these questions, by looking at the current economic conditions in view of these exit strategies and further outlining the similarities and differences identified amongst the three authors.

## 4.3 Critical analysis of Moyo's, Fee's and Tandon's exit strategies

The three author's main goal was to assist LDCs to achieve this goal of aid reduction, by providing a framework or strategies which LDCs can adopt. However, the "how" seems to differ and sparked a lot of debate just like the debate on the effectiveness of aid itself (Kuecken, 2013). Despite all of them having a common objective of ending foreign aid, in most cases they had different ways on how this may be achieved. A few similarities were also identified, namely institutional development, the importance of a mind-set adjustment and the need to change the current structure of the aid organisation.

To assess the feasibility of these strategies, a high-level analysis was conducted on the following aspects: similarities and differences; exit strategies, which were reviewed against the most common prevailing economic conditions in LDCs; criticisms made against them, which were also taken into consideration. The findings are highlighted below.

### 4.3.1 Institutional development

Both Tandon (2008) and Fee (2012) agreed and proposed institutional development as being one of the key aid exit strategies and prerequisite for LDCs to finance their own economic growth. Even though Moyo (2009) did not list institutional development as a key exit strategy, it was inherent in her recommendations which propagated accountability, rule

of law and government effectiveness. In addition, various studies have been conducted augmenting this view on the importance of institutional development. For example, Acemoglu and Robinson (2008) argued that the main reason for the differences in economic growth and development across countries was the difference in their institutions and that it is important for countries to develop an institutional framework if there are to see any improvements in their economic development.

There is no doubt that institutional development is a known critical factor for economic development, then why is it that most LDCs struggle in getting it right? Acemoglu and Robinson (2008) emphasised the importance of having a holistic view of institutions if sustainable institutional reform is to take place. Acemoglu and Robinson(2008) argued that most countries tend to focus on only one aspect of institutional reform, mostly economic institution, but forget that political institutions and property rights are just as important in influencing whether the process is successful or not. A complete change of focus from institutions to the factors and forces that keep bad institutions in place is what they recommended. With this in mind, Tandon's (2008) recommendation for institutional development might be difficult to implement in most African countries where political institutions are far from being ideal to support such a change. For example, most African countries are characterised by corrupt leaders who cling to power and there is a complete disregard for property rights which are key to the development of economic institutions (Acemoglu and Robinson, 2008). Therefore, adoption of Tandon's recommendation will require that LDCs devise new institutions both political and economic.

### 4.3.2 Mind-set adjustment

Tandon's (2008) recommendation that African leaders need a mind-set adjustment was agreed upon by both Moyo (2009) and Fee (2012). What African leaders need is a mind-set change, a mind-set that challenges the belief that Africa is a doomed continent plagued by poverty and disease (Mbeki, 2010, cited by Lekota, 2010). However, most African leaders find mind-set adjustment challenging and there is a tendency for them to stay in power for as long as they possibly can.

In addition, most African leaders have the tendency to stop and discourage any independent political activities that may bring in a new breed of political leaders (Chikerema et al., 2013). Tandon's recommendation is an ideal and noble one; however, if the status quo remains the same in most African countries, the achievement of such a change will remain a wish, as most African leaders will cling to power to continue benefitting from aid (Babeiya, 2011).

### 4.3.3 Pro-poor budgeting

Babeiya (2011) questioned whether the pro-poor budgeting, as recommended by Tandon (2009) might work with such weak economies, as most African countries are highly unlikely to effectively implement pro-poor budgeting policies. This view is also echoed by Fozzard (2011), who stated that developing a balanced budgeting framework has been a problem for most governments for the past sixty years. Most governments grapple with the question: "On what basis shall it be decided to allocate x dollars to activity A instead of activity B?" (Key, 1940: 1138 cited in Fozzard, 2011). However, efforts are being made by most LDCs to achieve this optimum balance. For example, the South African Minister of Finance presented what was described as a "pro-poor" budget for 2017, by introducing a new 45 per cent tax bracket for those who earn more than R1,5 million a year (Donnelly and Steyn, 2017). Another example was seen in the Philippines, when the current administration allocated P120 billion in its 2017 budget to the agriculture sector, in an effort to boost the lives of the farmers and fishermen of the country (Philippines Information Agency, 2017). These two cases illustrate and in a way link in with Tandon's recommendation and how it is possible to implement pro-poor budgets, taking into account each country's economic conditions.

### 4.3.4 Prioritising employment and decent wages

There is no doubt that prioritising employment and decent wages would be a key priority for any government, and is befitting for it to be included as a foreign aid exit strategy. However, prevailing conditions in most LDCs did not provide a conducive environment to pursue such a strategy. Tandon's recommendations were made in 2009, this was the period during which the world was experiencing the financial crisis triggered by the US sub-prime mortgage market, which would have made it difficult for LDCs to prioritise employment and decent wages. A few years later, in 2016, employment levels seemed to have not improved that much, as evidenced by the figures released by the International Labour Market (ILO), which states that the global unemployment rate is expected to rise from 5.7 to 5.8 per cent (ILO, 2017). This will see the number of jobless people increase to 3.4 million with a total aggregated number of unemployed persons forecasted to be just over 201 million by 2017 (ILO, 2017). The regions to be mostly affected by these unemployment figures will be the sub-Saharan Africa, Latin America and Caribbean regions. The report further stated that the number of workers earning less than $3.10 per day is expected to increase by more than 5

million in the next two years, this makes it even more difficult to implement Tandon's strategy of offering decent wages to employees.

With these conditions in mind, increasing employment and wages may be a difficult strategy to implement. Instead of focusing on creating more employment, which may be difficult at the moment, LDCs were advised to on what it could have easily achieved without requiring resources that is, improving their work ethics and professional conduct of civil servants, who were known for their laziness and corruption, which if corrected could have produced a productive society (Babeiya, 2011).

### 4.3.5 Creation and protection of domestic markets

Both Tandon (2008) and Fee (2012) believed in protecting the domestic market before opening it to the international world. However, Moyo (2009) argued differently, she suggested that LDCs should engaged in international trade, as it contributes to economic growth. Section 4.2.2.3 of the study has highlighted the benefits that trade liberalisation would bring according to Moyo (2009). Fee (2012) argued that trade liberalisation, in the short-term will not work in most LDCs, as they have neither the goods and services required, nor do they have the infrastructure capability to operate efficiently in global markets. As he puts it, "Africa has already missed the globalisation boat" (Fee, 2012: 216).

The case for closed markets was further promoted by Babatunde and Busari (2009) who argued that the economic meltdown and crisis in 2008 – 2010 lead to a major negative shock on Africa's markets. As a result, a change in strategy was required, i.e. from an export led to a demand led growth model. They believed that for Africa to implement a demand-led growth strategy new set of policies should be implemented that will ensure improved income distribution, good governance, financial stability and an adequately fairy priced supply of development finance. With the prevailing economic conditions, the majority of African countries falls short in having the prerequisites to implement a successful demand-led growth strategy. So, what is the way forward for LDCs with such conflicting advice and reports? Are LDCs better off with closed markets or not? Taking into account the different levels of economic growth, there are certain countries that are ready to trade with the outside world, for example, resource rich countries, whilst others still need to be protected mainly those that are agricultural-based. This view is also expressed by Tandon (2008) himself, indicating that this recommendation is not a panacea for all countries.

Tandon (2008) does agree that there are certain exceptions where globalisation will benefit a country, for example, Botswana, by exporting its diamonds and the Middle East exporting its oil. However, this is not applicable to the majority of LDCs. With so many minerals and resources in Africa: 10 per cent of the world's oil reserves, 40 per cent of its gold and 80-90 per cent of chromium and platinum, Africa should benefit from globalisation (Leke et al., 2010). Six years later, the tables have turned. It is the non-resource-intensive countries that have open markets that have performed well, with expected growth levels expected to rise up to 5.5 per cent in 2017 (IMF, 2016). However, the resource-rich countries that export have been negatively affected by the global economic slow-down and the forecast is for an expected growth decline of 1.5 per cent (IMF, 2016).

Taking into account all these factors, opening or closing its market to the international world will depend upon the country's economic state and condition, which again indicates the need for careful consideration before adopting these strategies.

### 4.3.6 Plugging the resource gap/reduction in expenditure

Tandon's (2008) fifth strategy to exit foreign aid was for governments to rather reduce their expenditure if there was a financial gap than seeking funds from aid. Again, adoption and implementation of this strategy will depend on the economic outlook of each country. For example, the current statistics on Africa's economic outlook review a two prone response to the current economic slow-down. In countries where the economic growth had slowed down, mostly in resource rich countries, government expenditure reduction was introduced, contrary to non-resource rich countries were they were experience a boom, government expenditure was increased (IMF, 2016). The IMF report further showed that countries that required financing for their savings gap turned to sources of financing other than foreign aid, namely, issuing bonds, as seen in countries like South Africa and Nigeria (IMF, 2016). There is also an urgent call by the ILO (2017), for government to increase public investment to provide the boost required to the global economy to reduce unemployment (ILO, 2017). This also highlights a contradiction to Tandon's (2008) recommendations of increasing employment and wages with the reduction of government expenditure. For government to create employment, they have to boost the economy and, in most cases, it is through an increase in spending.

Babeiya (2011) further criticised the reduction of expenditure proposed by Tandon (2008) as an exit strategy, which was only possible in democratic countries: in most African countries, where power and politics lies with only a few elites, expenditure reduction may prove difficult.

With this in mind, one can then see how Tandon's (2008) recommendation could be adopted by a country, whilst taking into account its own economic conditions. Again, this is not a panacea for all countries, as not all countries are able to secure alternative sources of financing in the international markets.

### 4.3.7 Limiting aid to national democratic priorities

In his last step, Tandon (2008) appealed for more aid to be allocated to democratic projects, this is justification enough to conclude that his strategies are not sufficient to end aid dependency (Babeiya, 2011). Babeiya (2011) concluded that Tandon's (2008) exit model provides more of a framework to facilitate growth than it is an end to foreign aid dependency.

### 4.3.8 Capital solutions and remittances

Moyo (2009) was heavily criticised for her neo liberal focused exit strategies, arguing that neo liberal policies tend to work against most African countries (Biney, 2009). Whitfield (2009) further criticised that Moyo (2009) had given solutions on how LDCs should raise money, through capital markets, remittance, but she had left out a critical element of structural constraints that these countries were facing to be able to appropriately implement these proposed solutions. Mukanga (2013) also criticised Moyo's (2009) recommendations on using remittances, that she conveniently forgot to balance her argument that evidence has shown that remittances are sometimes considered a 'curse'. There is no doubt that most African countries face a lot of structural challenges, coupled with the slow global economic growth, making it very difficult to effectively participate in the global capital markets.

However, this has not stopped the African bond market to expand, with bond sales having grown from $6 billion in 2012 to a record $11 billion in 2014 (Tafirenyika, 2015). However, recently, the bond market has declined due to the slow economic growth, seeing only Ghana entering the euro bond market in 2017 (IMF, 2017). On the other hand, a few countries that are not resource-rich countries have not been affected by the slump in oil and gold prices have managed to issue bonds, e.g. Kenya and Ethiopia (IMF, 2017). This indicates once again that the adoption of these strategies should depend on country-specific conditions, as no strategy provides a one-size-fits-all solution to ending foreign aid.

Remittances on the other hand have been on the increase bridging the gap where the impact of economic growth has slowed down. For example, remittances have been reported to be above 10 per cent of GDP of a number of sub-Saharan countries since 2010 (IMF, 2017). However, Fee (2012) argued that even though remittances were an important aspect of economic growth they will always be indicated as a small '*d'* in development, as their impact is minimal and not enough to impact the structural changes required for a sustainable economy. In most cases, only the immediate family who receives the money is impacted and there is no impact on the economy as a whole. Moyo (2009) argued differently stating that remittances provided a potential source of money to help LDCs development. Again, the importance of country specific conditions will determine which strategy or option that they would adopt. However, based on the statistics above, remittances are still regarded as an important element of a country's financing, but not an end in itself.

### 4.3.9 Domestic resource mobilisation

Various stakeholders agreed with Fee (2012) on the importance of domestic resource mobilisation. LDCs have continuously been urged to develop capacity to mobilize resources locally instead of looking for assistance outside the country (Nnadozie, 2015). Fee's (2012) recommendation for resource mobilisation does take into account the challenges that most LDCs face in terms of tax collection; but he still believes that domestic resource mobilisation is the key to unearthing Africa's financial requirements. It is estimated that African countries loose nearly US $60 billion a year to tax evasion (Mackie and Williams, 2016). This has seen the launch of the Addis Tax Initiative in 2015 where international donors, African and other developing countries have made a commitment to double their efforts to tax reform and domestic revenue by 2020 (Mackie and Williams, 2016). Therefore, this is a strategy that should be prioritised in most African countries.

### 4.3.10 Bilateral relations with China

One of the key differences amongst the authors was the development of bilateral relations with the Chinese. Moyo (2009) called the Chinese "our friends" and the benefits of trading with them have been highlighted in section 4.2.2.3 above. In contrast, Fee (2012) in his analysis of the BRICS model concluded that aid from the Chinese distorted aid initiatives and stunts local production, viewing the Chinese as being part of the problem. Mukanga (2013) also criticised Moyo (2009), stating that bilateral relations with the Chinese is no better option, as this also means concessional loans and long-term dependency.

Looking at the evidence on the ground trade between African countries and the Chinese seems to be on the increase with a 30 per cent year on year since 2011 (Albert, 2015). In 2010 the Chinese became Africa's largest trading partner surpassing the United States (Albert, 2015). The Chinese-Africa trade model, in which China provides low-interest, no questions asked, and loans to African countries with low credit ratings and in turn they would acquire favorable rights to the countries' resources, has received widespread criticism (Albert, 2015). This is what Fee (2012) criticized as being part of the problem. The model has been seen not to take into account Africa's long-term and sustainable development (Sun, 2014). They have often been characterized as being "evil", representing a selfish interest for natural resources, and being bad for Africa's governance and future sustainability (Sun, 2014).

Studies predict that China's engagement with Africa is expected to grow despite the ongoing conflicting views on the relationship. Adoption of this strategy will require to resolve the most fundamental problems highlighted to ensure both parties benefit from such a relationship (Sun, 2014).

### 4.3.11 Financial solutions for the unbankable/ micro-financing

Fee (2012) and Moyo (2009) did not agree on micro-finance being a key strategy to end foreign aid dependency. Moyo (2009) proposed that micro-financing presented a great option for the un-bankable masses of most LDCs, and an ideal source of funding to end aid dependency. Contrary, Fee (2012) argued that even though there is a lot of literature that promotes micro-financing, there is currently no proof that it is the right solution for the poor and therefore could not be included as a source of funding to end aid dependency. Hamam and Schwank (2011) had similar views to Fee (2012), that it is unreasonable to expect micro-finance to fundamentally transform African economies, but that it can play a role in providing basic financial services to the poor. Furthermore, the literature reveals that the success stories on micro-finance in Africa are not what they claim, as evidence shows that the poor got into debt through micro-financing. For example, in South Africa, by 2012, the country's debt amounted to 75 per cent of household disposable income (Itaman, 2017).

However, contradictory reports show a negative correlation between gender inequality and micro-financing, indicating that micro-financing has the ability to reduce gender inequality (Zhang and Posso, 2017). Studies have further shown that an increase in micro-finance of

about 15 per cent may lead to a decrease of 50 per cent in gender inequality (Zhang and Posso, 2017).

With such conflicting views, the decision to adopt micro-finance as a financing solution should take all these factors into account.

### 4.3.12 Economic diversification

Despite having poor supporting infrastructure for an optimum economic diversification, Fee (2012) believed that African economies should diversify through the development of their agriculture sector. This opinion is echoed further by a report by the McKinsey Global Institute (2010) which estimated that African agriculture sector could grow to $880 billion by 2030 (McKinsey Global Institute, 2010 cited by Fee, 2012).

The economic outlook and various reports agree with Fee (2012) that the need for economic diversification is high for most LDCs more so with the growth cycle at a low point, and without diversification the future of most LDCs is bleak (Deloitte and Touche, 2017). However, Babeiya (2011) argued that promoting the agricultural sector might not work as an alternative to raising finance. This is mainly due to the fact that agriculture is still perceived as a backward sector that is characterised by demoralised peasants. This is coupled with poor roads in rural areas making it difficult for farmers to transport their produce. Again, adoption of Fee's recommendation will depend on country specific conditions.

### 4.3.13 Global fund model

Fee (2012) believed that the successes of the Global Fund makes it an ideal example on which the foreign aid structure could be based upon to improve its performance. He argued that The Global Fund has been very successful in mobilising donor funds targeted at fighting against HIV/AIDS, TB and Malaria and vaccination. The figures released by the Global Fund themselves supports Fee's recommendation, which states their successes, namely: 20 million lives saved by 2015; a decrease in deaths of 1/3; as of July 2016, $30 billion had been disbursed.

However, the operations of the Global Fund are not without its controversies. At the time that Fee (2012) made his recommendation, the Global Fund was involved in a case of corruption of donor funds totaling $44 million, which saw donors pulling out, and a massive

restructuring of the organization followed thereafter. It is also important to note that the Global Fund is merely a financing organization and not an implementation agency (OECD, 2013). Again, the recommendation to adopt this model must take the above factors into consideration and not regard it as a panacea for foreign aid restructuring.

## 4.4 General criticisms made against the proposed exit strategies

Furthermore, the work of the three authors was criticised by various commentators. Moyo's recommendations were criticised as being full of broad generalizations on foreign aid (Whitfield, 2009). This view point is further asserted by Hoebink (2009) who stated that Moyo (2009) is too casual when using the sources of her arguments, most of her sources of supporting evidence were based on papers that were highly contested, and not really taken, as the right evidence to bid the case for or against foreign aid (Hoebink, 2009). Hoebink (2009) further argued that Moyo's (2009) solutions were not based on empirical assessment on how aid works, nor did she analyse the economic challenges faced by the LDCs. Mukanga (2013) was another economist who criticised Moyo's recommendations, stating "with deep sorrow" that the Dead Aid proposal falls short in many areas, namely: the work lacked clear analysis, it used unbalanced evidence and she treated aid in a homogenous and aggregated way, failing to show that some types of aid are effective. In short, Mukanga (2013) states that Moyo's (2009) exit strategies were ineffective, as they were based on an incorrect diagnosis of the actual problem.

Fee's (2012) strategy was also criticised. Kuecken (2013) criticised Fee's (2012) strategy as being 'somewhere between the academic and the practical'. Kuecken (2013) argued that Fee (2012) had 'cherry picked' his evidence to suit his viewpoints and had ignored the main debates regarding these topics. Kuecken (2013) further criticised Fee's (2012) recommendation of implementing the five strategies simultaneously, stating that, it was almost impossible to achieve. However, Kuecken (2013) did not offer any alternatives on how to deal with the weaknesses he had identified in Fee's (2012) recommendations.

Stone (2012) questioned whether Tandon's (2008) strategies were sufficient and necessary to achieve the level of development required, as he left a lot of questions unanswered. Babeiya (2011), conducted a critical analysis of Tandon's (2008) work and argued that Tandon's (2008) exit model is quite a useful tool as an implementation guideline to end aid, but not a means to end foreign aid dependency. Babeiya (2011) further stated that Tandon's (2008) recommendations were made further unattainable due to the lack of proper

implementation steps and an explanation on how Africa was to get itself out of the clutches of the economies of the west that there are currently in.

## 4.5 Conclusion

The main purpose of this chapter was to provide an outline of the proposed exit strategies by the three authors, namely Tandon (2008), Moyo (2009) and Fee (2012). The emphasis was on providing a high-level outline and analysis of the proposed exit strategies. Tandon's (2008) main argument was that aid is not what it claims to be, as it has not lived up to its expectations nor delivered what it had promised. Tandon (2008) based his main criticism of foreign aid on what he classified as an inappropriate definition of aid, and questioned if the current foreign aid definition correctly defines or constitutes what foreign aid is, thereby not addressing the real need or requirement. Some of Tandon's (2008) criticisms included the following factors: donors' inability to keep their promise of donating the agreed target rate of 0.7per cent of their GNI; governments were not accountable to their citizens, but rather to the donors; and foreign aid left governments with a huge debt to service. Tandon's (2008) recommendations aimed to reduce aid dependency, through the following seven steps: adjusting the mind-set; budgeting for the poor, not for the donors; making employment and decent wages the priorities; creating the domestic market and owning domestic resources; plugging the resource gap; creating institutions for investing national savings; and limiting aid to national democratic priorities.

Secondly Moyo's (2009) strategies were then outlined. Similarly, Moyo (2009) first outlined the flaws she had identified within the foreign aid world and why she believed that aid was the silent killer for growth. The Marshall Plan was not the ideal blueprint for Africa, as foreign aid came with unfavourable procurement conditions, and democratic policies are not ideal for LDCs, but rather dictatorship, these were some of the criticism that Moyo (2009) raised against foreign aid. Moyo (2009) proposed the following initiatives regarding how LDCs could raise finance: involvement in the bond market, free trade, foreign direct investment, tax reformation (i.e. less taxing of remittances), development of micro-finance institutions. Moyo (2009) believed these strategies would assist Africa to reduce its dependency on aid.

Fee (2012) was the last author that this section of the chapter outlined. The section outlined his criticism and recommendations in the same manner as did Tandon (2008) and Moyo (2009). Fee's (2012) main argument was that LDCs should find another source of funding, as donor fatigue was creeping in. To this end, Fee (2012) proposed the following five

strategies as an alternative to foreign aid: institutional development, domestic resource mobilisation, economic diversification, increased global funds and, lastly, self-help aid (Fee, 2012).

Section 4.3 provided the findings of the literature review conducted on the feasibility of these proposed strategies. The analysis outlined the differences and similarities between the three author's recommendations. One common strategy was identified, and that was of institutional development. Institutional development seemed to have been a cornerstone of these strategies, and rightly so. Adjustment of the mind, organisational change of the aid world and savings were some of the similarities identified. However, there seemed to have been more differences than similarities. There were three main differences identified between Moyo (2009) and Fee (2012). The bilateral relations with the Chinese, micro-financing and Remittances. Moyo (2009) believed that these three strategies would assist LDCs to reduce their dependence on aid, whilst Fee (2012) thought differently. Moyo (2009) again differed from Tandon (2008) on international trade. Tandon (2008) argued that LDCs were not yet ready to trade and still need to protect their industries until they had matured to a certain stage.

The feasibility of these strategies was questioned and criticised by a number of academics, as discussed in Section 4.3. Moyo's (2009) recommendations contained a number of criticisms. These were: choice of neoliberal strategies when there were known for their negative impact on LDCs, the recommendation that LDCs would rather have a dictator than adopt a democratic state, the work lacked relevant empirical evidence and proper analysis, nor did she give recommendations on how to implement her strategies (Mukanga, 2013; Biney, 2009; Whitfield, 2009). Fee (2012), on the other hand, was criticised because his work left a lot of questions unanswered (Stone, 2012). The main criticism of Tandon (2008) came from Babeiya (2011), who stated that most of Tandon's (2008) work had raised core issues on aid and provided an excellent implementation guideline, but none of Tandon's (2008) recommendations were a means to end foreign aid dependency. Embedded in this section was the results of the feasibility of these strategies within the current prevailing economic conditions. There was common strand evident in the analysis, i.e. that each of these strategies was not a panacea to end foreign aid, but rather a means to an end. Adoption and implementation of these strategies had to take into account whether the country is ready to implement the chosen strategy, which requires taking into account its economic conditions. The results varied from one country to the other, as one would envisage.

In conclusion, the recommendations put forward by the three authors provides a strong starting point for most LDCs, while taking into account each country's circumstances, and does not provide a one-size-fits-all-approach. The fact that there are differences amongst the three authors, prompts a careful consideration before adopting any of these strategies. Biney (2009) asserts that the differences between Moyo (2009) and Tandon (2008) strategies stems from their different experiences in terms of their work background.

However, it is important to assess whether these strategies have been successfully implemented by any LDCs in their aid reduction journey and what were the lessons learned from them. This is the topic of the next chapter.

# CHAPTER 5

# COUNTRY CASE STUDIES

## 5.1 Introduction

Aid reduction may seem like an elusive objective to be attained, as seen by the number of developing countries who are still dependent on foreign aid. However, studies have shown that developing countries are rapidly reducing their dependence on aid since its levels peaked in 2002 (Action Aid, 2013). In 2002 aid fell by 22 per cent in low income countries (LICs) and 20 per cent in least developed countries (LDCs) (Action Aid, 2013). As of 2012, some of the countries that have managed to reduce aid included: South Korea, Mauritius, Botswana, South Africa, India, Costa Rica, Tunisia, Morocco, Malaysia and Singapore (Fee, 2012). Key to their success was their increased revenue mobilisation, and sustained economic growth (Action Aid, 2013). Even though these countries reduced their dependency on aid, there were and still are cases where aid is used for specific projects or cases, like health in the case of Botswana (US Federal Budget, 2012). Heldgaar (2008) stated that aid by nature was meant to be temporarily, but the majority of LDCs seemed to have been and still are permanently dependent on aid. One of the reasons identified was that little emphasis and focus was placed on when and how aid would stop, resulting in a continuous reliance on aid (Heldgaar, 2008). This chapter will therefore add to the existing literature on lessons learned on how to reduce foreign aid dependency.

The main objective of this chapter is to review three prominent countries that have successfully managed to reduce aid, namely Botswana, India and South Africa. There are very few empirical studies conducted and documented on how countries have managed to reduce foreign aid. The only existing literature on aid exit were based on these three countries, therefore, they formed the basis of this literature review.

As is the case in most countries except for India, donor exits are initiated by the donor for a number of reasons, these being: firstly, the graduation argument, where a country's economic status is now classified as a developed economy and does not require aid, for example, South Africa, India and Botswana. Second is the governance/mismanagement argument, where a country has mismanaged donor funds, like in the case of Malawi. Third is the conflict argument, this is the case where the country is undergoing conflict due to political

instability, for example, in the case of Eritrea (Heldgaar, 2008). It is important to note that only India, of the three countries under study, voluntarily announced the decision to reduce aid (Heldgaar, 2008).

The country analysis was conducted within three categories. Firstly, a general investigation of the country was done, with the focus being on the prevailing conditions, that is, the social, economic and political environment and its aid allocation levels. Secondly, the aid exit decision was investigated. The focus was on when and why the decision was made; what policies were adopted to enable the exit or reduction process; how the exit strategy was implemented, and most importantly, the consequences of aid reduction. The literature sources for the analysis will mainly be based on the Donor Evaluation Research Reports commissioned by SIDA (Heldgaar, 2008; Slob, 2008; Tjonneland et al., 2008; De Groot, 2008).

The chapter is made up of six key sections. Section 5.2 outlines the first country under study, Botswana. The section consists of three components, section 5.2.1 which provides a brief country background focusing on factors like population, economic status and their brief aid history. This is followed by section 5.2.2, which outlines the aid reduction strategy management, highlighting its key enablers or determinants to the exit process. Section 5.3 looks at the second country under review, that is, South Africa. Its social and economic background are outlined, followed by an explanation of how the country managed to reduce aid in sections 5.3.1 and 5.3.2. India's case study is outlined in Section 5.4, and the country's background and exit management process is outlined in sections 5.4.1 and 5.4.2. Both positive and negative consequences for aid reduction are indicated in Section 5.5. Section 5.6 presents findings of the comparative analysis done between the exit strategies that were proposed by the three authors and the strategies utilised by the countries in their aid reduction process, which assists in identifying similarities and differences in the approaches. The chapter concludes with section 5.7, which provides a summary of the main points and views presented in the chapter.

## 5.2 Case study one: Botswana

### 5.2.1 Brief country background

Botswana is a landlocked country located in the southern part of Africa, with a population of about 2.3 million, as of 2016 (The World Bank Data, 2017). Botswana became independent

in 1966, and: GDP was 33.7 billion in 2015; income per capita was $6,300 in 2015 (The World Bank Data, 2017). Exports were estimated to be at $6.5 billion, as of 2015, with diamonds making up 60 per cent of the total (Fee, 2012). In 2004, Botswana was said to be the world's top diamond producer, having started production in 1968, but only dominating the industry and economy a decade later (Fee, 2012). Although Botswana was one of the world's poorest countries at the time of independence in 1966, its GDP reached an all-time high of $7574.30 by 2014, which is equivalent to of 58 per cent of the world's average (Trade Economics, 2017).

Botswana's foreign aid history dates as far back as 1966, when it first got its independence. Due to its favourable environment, Botswana was one of the most attractive destination for foreign aid that it became the largest recipient of aid amongst all developing countries.

It had both bilateral and multilateral donors from almost 12 countries, and aid consisted of almost 60 per cent of its recurrent budget (Kerapeletswe et al., 2008). The following were the main donor countries for Botswana : United States of America, United Kingdom, Germany, Sweden, Netherlands, Norway and China. Aid focused in the following sectors: education, health, water, energy and environmental. In 1978 aid percentage decreased to 18 per cent of government spending and was down to 0.4 per cent of government expenditure by the end of the 1990s (Fee, 2012). Study conducted by Hatemi and Irandoust (2005) found that there was a positive correlation between foreign aid and economic growth in Botswana.

The only cloud on the horizon for Botswana was the country's levels of HIV/AIDS which seriously affected its human resources (Fee, 2012). Botswana had one of the highest levels of HIV/AIDs in the world, that is, more than 22 per cent of its population were affected, as of 2016 (The World Bank Data, 2017). This has forced the country to depend on foreign aid to run its HIV/AIDs programmes until today. In 2009, the government provided almost 66 per cent of the $340 million required to fund such programmes and the rest coming from donors like the Bill and Melinda Gates foundation (Moyo, 2009).

Botswana was dependent on foreign aid for over 25 years, and this was not different from any other developing country. However, unlike most countries, Botswana managed to continuously develop its economy by effectively utilising donor funds, whilst the majority of LDCs failed to do so (Slob and Jerve, 2008). Yes, Botswana had diamonds, but so did other

resource rich countries. What was unique about Botswana was its excellent governance system. Slob and Jerve (2008) further stated that Botswana has a centralised way of managing aid, strong institutions that incorporate aid into the development plan. The country was characterised by little or no corruption, low crime rates and a clear vision on how to achieve its strategic objectives (Slob and Jerve, 2008). Aid was mainly used to develop its physical and social infrastructure and economic diversification (Carlsson et al., 1997).

By the 1980s Botswana began showing budget surpluses and it became quite clear that financial aid was not needed anymore, and Botswana was reclassified as a middle income country. As stipulated in the donor rules and regulations, middle income countries did not qualify for aid, this led to major donors restructuring their aid and exiting the country. Botswana was then classified as the first African country to graduate from aid, based on its middle income status (Kerapeletswe et al., 2008).

### 5.2.2 Botswana's foreign aid reduction management strategy

5.2.2.1 Pre-exit management strategy

Botswana's exit from aid was triggered by donors when it was classified as a middle income country. Slob and Jerve (2008), highlighted the following as being the main drivers why Botswana did not to qualify for aid anymore:

- First was the graduation argument which was given to a country that could manage its economy without aid. In 1992, Botswana's GDP per capita status changed to middle income status and therefore it was unable to attract anymore aid;
- Secondly, Norway's reason for ending aid in Botswana was that there was an over-supply of aid and therefore Botswana was unable to absorb any more aid; and
- Lastly, Denmark's exit was due to a lack of cooperation by the Botswana government in sorting out issues with a certain ill-fated transport project.

5.2.2.2. Exit management strategy

Once the donors announced the intention to exit from Botswana, clear and comprehensive exit plans were defined in consultation with the donors. These exit plans were implemented over a period of 3 to 4 years. Some of the key components of the exit plan involved, gradual reduction of aid over three to four years, natural phasing out of programmes without disruptions. All four donors (Norway, Sweden, Denmark and the Netherlands) agreed that they would maintain their presence in inter-institutional cooperation without any further aid funding and funding to remain on key sectors like health. Even though Botswana was ready

for aid reduction, it still complained that it should have been given more time for phasing out, especially with projects that required a lot of technical assistance, as the country did not have the right level of skilled human capital at that point in time (Kerapeletswe et al., 2008).

Botswana adopted a number of policies that supported its aid reduction process. It opened its doors to outside trade. Macro-economic stability was achieved through conservative policies by adopting a competitive exchange rate and raising cash reserves, at times in excess of $6 billion with budget surpluses from 1983 to 1998 (Fee, 2012; Moyo, 2009).

There were also three unique factors that contributed to a successful aid reduction process in Botswana. These were pre-existing good institutions, well-managed governance systems and government policies. Firstly, Botswana's good institutions were embedded in their private property rights, as stipulated by Acemoglu et al. (2011). These institutions protected the property rights of investors and provided political stability. Unlike many African countries, Botswana had a relatively inclusive pre-colonial institutions, which British colonisation did not destroy either. The wealth from the diamond trade was evenly distributed therefore thwarting any potential of undermining the governance of good institutions. Secondly, Botswana had very good governance systems in place promoted by its leadership of Seretse Khama and Quett Masire. Botswana demonstrated all the characteristics of a well-governed state, namely stability and social order, a government that was not corrupt and self-serving, protected property rights and maintenance of a sound economic system (Acemoglu et al., 2011) Acemoglu et al. (2011) further stated that Sereste Khama's handling of the independence negotiations, constitutional convention, minerals policies and general political issues, ensured that there was general support of the policies that his party proposed; policies that ensured that there was political stability and an environment with secure property rights. As a result, Botswana, had no civil wars or infighting to control the revenues from the diamonds, in contrast with most African countries that have abundant natural resources (Slob and Jerve, 2008).

## 5.3 Case study two: South Africa

### 5.3.1 Brief country background

South Africa is classified as one of the richest countries in Africa, an upper middle income country with a gross national income (GNI) per capital of $12,240 (as of 2013), with average growth rate of approximately 3.3 per cent per annum between 1994 and 2009 (OECD,

2011). As of 2017, South Africa has an estimated population of about 56 million, 50 per cent of whom live below the 36 dollars income poverty line (Omarjee, 2017). Despite a strong macro-economic performance, excellent fiscal policies, good infrastructure and diversified economy, as of 2017, South Africa had one of the highest unemployment rates in comparison to other African countries of about 27.7 per cent, with Botswana at 18.4 per cent, Gabon at 18.5 per cent and Namibia at 25.5 per cent (Yu, 2017).

Aid into South Africa started during the first few years after apartheid in 1994, which was intended to assist in promoting a stable society (Leshoro, 2012). Aid came in from many developed sources, namely: the United States, United Kingdom, Germany, France, Denmark, The European Union, International Monetary Fund, United Nations Development Programme and United Nations Children's Fund (OECD, 2011). From 1994 aid grew from $410 million dollars to $1.4billion in 2015. Aid then fell from $1.4billion to $994million in 2017 (World Bank, 2017). Foreign aid in South Africa was mainly used to support the following initiatives: Education and skills development, democracy and good governance, small business support, urban environmental support and HIV/AIDS programmes. According to a study by Feudjou (2014) foreign aid had a positive and significant impact on South African's economic growth based on the data from 1994 to 2010.

Since 2005, South Africa has been receiving a net ODA averaging about 0.3 to 0.4 per cent of GNI and approximately 1 per cent of the government budget per year, therefore usage of ODA was not highly prioritised (OECD, 2011). For example, it was reported that most government institutions considered aid as an alternative source of flexible and non-bureaucratic way of accessing external assistance, as most funding had to be obtained through the time-consuming channels, for example, the tendering process (Tjonneland et al., 2008).

Another characteristic of South Africa's aid world is that it also acts as donor to other African countries. This is done through one of the prominent aid programmes called the African Renaissance and International Cooperation Fund (ARF) (Yanacopolos, 2012). The ARF main mandate was to focus on predominantly African countries and it sought to promote democracy, humanitarian assistance, conflict prevention and resolution, and good governance (Yanacopolos, 2012).

### 5.3.2 South Africa's foreign aid reduction management strategy

5.3.2.1 Pre-exit management strategy
South Africa started receiving foreign aid after it was already classified as a middle income country, therefore its graduation from aid was not triggered by its income status, but by other political and economic factors (Ramkolowan and Stern, 2009). Reduction of aid by donors for example, EU, USAID, Norway, Sweden, Denmark and the UK started in 2000. The main approach followed by most donors was to allow for the existing programmes to be supported until finished in accordance with their contracts and agreements. Ramkolowan and Stern (2009) elaborated further that key to the transformation process was the need to maintain strong bilateral relations with South Africa than the need to phase out aid. For example, Sweden and Norway's emphasis was to facilitate and fund institutional cooperation through aid programmes. The exit process outlined below is based on the four main donors, namely, Norway, Sweden, the Netherlands and Denmark.

5.3.2.2. Exit management strategy
Tjonneland et al. (2008) identified a number of trends in how the four main donors made their exit from South Africa. Firstly, Norway and Sweden started reducing aid in 2000, whilst Denmark only started to do so in 2006. Contrarily, at a time when most donors were reducing aid, the Netherlands was increasing its aid spending in the areas of education and HIV/AIDS, but by 2007 the emphasis had changed to cooperation, as was the case with all the other countries. Norway and Sweden still maintained broader and institutional cooperation in their country support programmes after they phased out their aid activities, whilst the Danish ODA expired in 2006, but maintained strong support in the business-to-business partnerships and regional activities that South Africa was involved in (Tjonneland et al., 2008). All four donors included support for South African's regional activities to the rest of Africa and the areas of HIV/AIDS. Main constraint faced by the South African government was the lack of human capacity to manage the projects as the donor staff pulled out (Ramkolowan and Stern, 2009).

## 5.4 Case study three: India

### 5.4.1 Brief country background

India is ranked as the world's seventh-largest economy by nominal GDP, with a population of about 1.2 billion people and part of the G-20 major economies as of 2017 (The World Bank Data, 2017). India's economic development has been heralded as one of the most

significant achievements of the recent times with an average GDP growth rate of about 6 per cent in the last 5 years, and was expected to surpass China's economy (Statista, 2017). Despite its significant economic growth, India still has high levels of poverty, malnutrition and environmental degradation (De Groot et al., 2008); with over 30 per cent of its population living below the poverty line of $1.90 a day as of 2016 (Business Today, 2016).

India's foreign aid history dates as far back as the end of the Second World War, being one of the first and largest recipient of aid, estimated at almost $55 billion as of 1992 (Kamath, 1992). De Groot et al. (2008) indicated: external assistance to India was about 10 per cent of total public sector investment; in 2001-2002 bilateral aid totalled 1.14 billion from 31 donors. In 2009 alone, India's net official development assistance received was estimated at US$2.5billion (Fuchsa and Chaitanya, 2012). The main donors to India were: United States of America, United Kingdom, Norway. Netherlands, Sweden and Denmark. Aid in India was mainly used to finance and sustain the centralised planning and control framework (Kamath, 1992). A study conducted by Kalpana and Narayan (2013) found that there was a positive correlation between foreign aid and economic growth in India between the years 1976 – 2010.

Despite having one of the highest poverty levels in the world, India is itself a donor. In their study, Fuchsa and Chaitanya (2012) concluded that India's choice to be a donor was mainly for reasons of commercial and political self-interests, i.e. to gain access to overseas markets and to secure natural resources.

#### 5.4.2. Pre-exit management strategy

There were a few triggers for aid exit in India, these are outlined below as stipulated by De Groot et al. (2008). Firstly, there was the graduation argument, i.e. that India's economy had transformed into a developed economy in 2003; therefore, the need for financial aid had decreased. Secondly, the donors reacted by freezing aid when India conducted a nuclear test in 1998. This led to a drastic reduction of bilateral projects, from eleven to four projects in 1999 to 2002, due to the nuclear testing. The main donors, like the Swedish, still supported India, but channelled the support through NGOs, civil society and organisations such as UNICEF and the World Bank. The third and main reason for aid reduction was recipient induced. In February 2003, India's Minister of Finance announced in his annual budget speech that they no longer required aid assistance based on three major reasons namely: donor interference with its domestic affairs; boosting its image of self-reliance; and to reduce the burden of aid. The decision accelerated the exit of donors from India as main donors had already started the scaling down aid process. De Groot et al. (2008) further

elaborated that even when the country was hit by a tsunami in 2004, India refused to accept the humanitarian aid being offered, as it believed it had the necessary resources to deal with the situation. India's decision to exit from foreign aid was regarded as being unique in the aid world, and this made it easy for donors to pull out. This led to aid decreasing from 1.4 per cent in 1991 to 0.5 per cent in 2000/1 and their debt service ratio decreasing from 35.3 per cent in 1990 to 4.4 per cent in 2000 (De Groot et al., 2008).

#### 5.4.3. Exit management strategy

Once the decisions were made a special plan was drawn up by the Ministry of Foreign Affairs detailing how the exit would occur and how the relationships with the donors would be handled in the future. India's aid reduction strategy was similar to that of South Africa and Botswana, where donors phased themselves out once their projects were finished. However, in the case for India the process was accelerated after India's Budget Speech in 2003. The most prominent bilateral donors (Denmark, Norway, Sweden and the Netherlands) phased themselves out of India, but they all continued their assistance in terms of institutional cooperation and bilateral relationships. To ensure a successful exit process, the Danish government brought in extra human resources to help facilitate the exit process (De Groot et al., 2008).

Being a recipient driven exit decision, no major consequences were experienced due to the scaling down of aid. To fill in the gaps, the government allowed external commercial borrowings from non-resident lenders for Indian corporates (De Groot et al., 2008). Interestingly, as most donors were reducing and exiting India, the government of the United Kingdom insisted on giving more aid to the country, even though the Indian government did not want foreign aid anymore (Gilligan, 2012). Gilligan (2012) reported that most donors had wound down their funding in India, as the country has been classified as a middle income country with 10 per cent economic growth in the last few years. It was therefore quite surprising that the United Kingdom still believed that India's poor could still benefit from the British aid, even though, the Indian government said they had enough resources for their initiatives (Gilligan, 2012).

## 5.5 Consequences of aid reduction

In poor countries aid reduction has had disastrous consequences, for example, in the case of Malawi, when the Danish government exited from Malawi, leading to a 40per cent shortfall in the agricultural sector budget (Heldgaar, 2008). The same fears were raised when the US

government announced its intention to cut its foreign aid budget, stating that these cuts would severely affect women and children who rely on US funding for healthcare and family planning (Rueckert, 2017). Contrary, aid reduction had no major impact on the economy of three countries under study.

The consequences of aid reduction were different for each country as it all depended on the country's economic and financial status at the time when aid was being reduced. All three countries did not experience any major negative impact on their economies as a result of aid reduction. This was due to two main reasons. Firstly, in all three countries under study, the aid component consisted of a small percentage of their budget, therefore not significant enough to cause any major negative consequences (Slob and Jerve, 2008). Secondly, all three countries had other sources of funding and capacity to manage (Heldgaar, 2008; Ramkolowan and Stern, 2009). In their study, Ramkolowan and Stern (2009) found no evidence of any significant distortion of the South African government's budget as donors pulled out. On the contrary, studies have found that aid reduction has had positive consequences, as it has enhanced accountability and local ownership in the cases of India and Botswana (Slob and Jerve, 2008). In addition, in the case of India, being a recipient driven decision to exit aid made the transition easy with few negative consequences experienced (De Groot et al., 2008). The only negative consequence suffered by these three economies, was their lack of skilled human capital to design and try out new innovative approaches for their projects as donor staff pulled out (Heldgaar, 2008).

It is important to mention that aid still exists in some of these countries. For example, in their study on SA, Ramkolowan and Stern (2009) questioned the reasons why there were still projects being funded by donors in 2009 when the announcement to exit South Africa was made nine years earlier in 2000. Similarly, in 2017, aid was still present in Botswana's critical sectors, for example, health sector (OECD, 2017).

## 5.6 Comparing Fee, Moyo and Tandon's recommendations against the country case studies

This section of the chapter presents a comparative analysis between the strategies adopted by the three countries and the strategies that were recommended by the three authors. The aim was to assess whether the strategies that were recommended did work and if they had assisted any countries in their aid reduction process. The analysis showed that there was alignment across a number of the exit strategies that were proposed and those that were

utilised by the three countries, namely: institutional development; mind-set adjustment; pro-poor budgeting; the creation of employment and decent wages. However, not all strategies were evident in the country case studies, for example, plugging the resource gap/reduction in expenditure and limiting aid to national democratic priorities. This shows that these strategies are merely guidelines and not a panacea and it is important for countries to select only those that align with their social, political and economic factors. An interesting insight was that most of the strategies that were proposed by the authors were already in existence at the time the decision was made to reduce foreign aid in all three countries, indicating the importance of pre-exit planning and management. Outlined below are the key findings of the analysis.

Firstly, a major contributing strategy that enabled all the three countries to successfully reduce aid was that they had alternative sources of funding, which is sadly not the case in most LDCs and therefore unable for most of them to even consider the idea of aid reduction (Acemoglu et al., 2011; Tandon, 2008; Fee, 2012; Moyo, 2009). Secondly, a critical prerequisite for aid reduction process was institutional development (Tandon, 2008; Fee, 2012). All three countries had well developed and governed institutions in place. For example, Acemoglu et al. (2011) showed by means of a cross country evidence that Botswana's aid reduction success was due to their pre-existing institutions which were embedded in their property rights.

Thirdly, the importance of mind-set adjustment (Tandon, 2008), was demonstrated by the determination and commitment of the Indian leadership when they announced in 2003, as well as in 2012, that they do not want to receive aid anymore (Gilligan, 2012). Similarly, Botswana and South Africa were initially resistant to donors leaving, however, they quickly changed their mind-set, accepted the new developments and reduced aid successfully. This shows that mind-set adjustment is a key determinant for aid exit and aligns with Tandon's (2008) recommendation. Fourthly, pro-poor budgeting was another strategy that aligned to Tandon's (2008) recommendation. Evidence was seen in South Africa where the countries budget was well balanced budgeting favouring the poor whereby a new income tax bracket for those high income earners was introduced (National Treasury, 2017). The fifth finding was regarding remittances as an exit strategy. India was seen to be utilising them as another source of income, as recommended by Moyo (2009), but this was not the case in Botswana and South Africa. India was the world's leading receiver of remittances, accounting for over 2.9 per cent of India's GDP in 2016 totalling $68.9 billion (The Times of India, 2017). On the other hand a study conducted by Campbell and Kandala (2011) showed that remittances had no significant influence on poverty in Botswana, indicating that they had no impact on

the economy. Sixth finding was on employment creation which seemed to be an inherent policy that all three countries were and still are pursuing in their respective countries. It was reported that India's unemployment rate halved from 9.5 per cent in August 2016 to 4.8 per cent in February 2017 (Indian Express, 2017). The Indian Express (2017) further stated that this was due to the efforts by the government to provide employment in the rural areas. The same can be said about South Africa as having one of the highest unemployment rates in the world, of 27.7 per cent as of the first quarter of 2017 (Trading Economics, 2017). This has led to the South African government embarking on different initiatives to create employment as announced in the 2017 budget speech. These initiatives are the Agriculture Growth Initiative, funding for small businesses and private sector investment (National Treasury, 2017).

However, as stated in section 4.3.4, application of this strategy largely depends on the economic status of the country, and that most LDC countries struggle with balancing the different policies to ensure sustainable job creation. The seventh finding was that all three countries had bilateral relations with China during the aid reduction process. Botswana's relationship with China were first established in 1975, and formalised again in 2010. Botswana-China bilateral trade rose from US$52.4m in 2004 to US$149m in 2007 (Matorwa, 2017). However, this relationship was affected because of the intention of the Botswana human rights group to host the Dalai Lama who is viewed as a separatist in China (Kuo, 2017). As for South Africa, their official relationship was first established in 1998 and became South Africa's largest trading partner by 2010 and went beyond economics, politics and ideologies (Olander and Van Staden, 2016). For example, the two countries were aligned on more sensitive issues like internet freedom, international justice and the Dalai Lama (Olander and Van Staden, 2016). The Indo-China relations began in the 1950s, with China becoming India's largest trading partner in 2008 (The Times of India, 2012). However, currently the relationship between the two countries is deteriorating due to the border military issues in Bhutan (The Times of India, 2012). Lastly, foreign aid is still present in the three countries to this day, mainly for health and humanitarian disasters, especially in India for their healthcare, water and education projects (USAID, 2017) The same can be said for Botswana's HIV/AIDS programmes (Acemoglu et al., 2011). This aligns with the exit strategy recommended by Tandon (2008) whereby he stated that aid should be limited to national democratic priorities.

However, the countries seemed to differ on how they approached a number of the recommended strategies, namely: the creation and protection of domestic markets strategy; domestic resource mobilisation; micro-financing; and economic diversification. Firstly,

Botswana opened its markets to export its diamonds (Tandon, 2008), whilst India was a closed market until 1991, to protect itself and to achieve a level of self-reliance (Locke, 2015). This demonstrates how these strategies should take into account a country's circumstances when being considered for adoption.

Secondly, domestic resource mobilisation was and still is one of the critical strategies for any country to adopt if they want to find an alternative source of financing, as recommended by three authors. Different approaches were seen amongst the three countries under review. South Africa was recently ranked the best in the world for having the best tax system, stating that South Africa has enough resources of their own to eliminate extreme poverty, this clearly shows that resource mobilisation is working in South Africa (Business Tech, 2017). Unlike most countries South Africa's tax reformation initiatives have been successful as evidenced by the money being collected by the authorities. However, the effective usage of these resources is still questionable as there are still high rates of inequality (Business Tech, 2017). The same tactics were used by the Indian government where they rolled out its biggest tax reform in over 70 years in July of 2017(Choudhury, 2017). This they hope will boost India's tax receipts and provide simplicity, which they estimate will add about 40 basis points to India's economic growth (Choudhury, 2017). However, with Botswana, there seems to be a different story emerging. As of January 2017, Botswana was on the brink of being black listed as a tax haven where tax policies and secrecy in the country facilitate tax dodging and money laundering, an accusation which the government has denied (Tabane, 2017). Tabane (2017) further stated that between 2003 and 2012 Botswana lost over P80.5 billion in tax evasion. This is no surprise as most African countries loses almost US$60 billion a year to tax evasion (Mackie and Williams, 2016).

As was the case in Fee (2012) and Moyo (2009) not agreeing on micro-financing as an exit strategy, the same is the case amongst the three countries under study. Micro-finance existed in all three countries during the period they reduced foreign aid. However, conflicting evidence is seen in all three countries. Firstly, in India's case micro-financing has always been a big part of India's financial system (Assocham, 2016). The Grameen bank introduced micro-credit in Bangladesh, and the model was soon adopted in most LDCs (Moyo, 2009). In addition, India is also home to the world's largest micro-financing programs self-help groups (SHGs). This is a financing model whereby a small group of rural women form their own mini bank with links to a formal bank. It has approximately $2 billion in savings and $8.9 billion in outstanding loans (Assocham, 2016). However, despite these figures, a study conducted by Banerjee et al. (2010) on the impact of micro-finance in Hyderabad, India, found that micro-finance had mixed effects on business and little to no

effect on women's empowerment or children's education, which was the core objective of the micro-credit model (Banerjee et al., 2010). The same can be said for South Africa, where one study showed a positive impact and significant improvement, namely, increased business income, improved access to life-enhancing facilities, and the empowerment of women (Afrane, 2002). However, a contrasting view was presented by Bateman (2013), which stated that micro-finance was a disaster for South Africa. Bateman (2013) argued that 40 per cent of the South African workforce's income was spent on repaying debt, and people were caught in a micro debt-trap. Bateman (2013) further stated that the small proportion of individuals that had opened up small businesses did not have any major impact nor drove the sustainable development of the country. While in Botswana's case conflicting evidence was also presented. A study conducted by Okurut et al., (2006) suggested that micro-finance has a positive impact on household income and may be used as a potential tool for poverty reduction. However, in 2014, they did another study to confirm their earlier findings of 2006 and found no evidence of positive impact on Botswana economy contradicting their earlier findings of 2006 (Okurut et al., 2006). Although recommended by Moyo (2009), the micro-financing approach is seen (above) as working in India, but not in Botswana and South Africa.

Economic diversification was and still is a corner stone for all countries regardless of economic status. India has diversified across various sectors, the main ones being: the services sector – 31 per cent of GDP: trade, repair and hotels sector at 18 per cent; manufacturing at 18 per cent; public administration, defence and other services at 13 per cent (Gosh, 2016). The same can be said of South Africa, where: the main sector was the financial sector, which contributed about 22 per cent of its GDP; general government services contributed 17 per cent; wholesale, retail, motor trade, catering and accommodation contributed 15 per cent; and manufacturing contributed 15 per cent (Brand South Africa, 2014). However, Botswana's economy was not as highly diversified. In 2008, Botswana largely depended on its mining industry, at 52.9 per cent; with services at 45.2 per cent and agriculture at only 1.9 per cent (Sekwati, 2011). The problem with over-reliance on one sector is that in 2009, Botswana's GDP declined by 4.6per cent due to the global recession which affected their mining sector by suffering a decline of 31.4 per cent (Sekwati, 2011). Again, it is shown here that Botswana managed to reduce aid without a diversified economy, however, this does not take away the fact that economic diversification is key in aid reduction process.

This section has shown that countries that reduced aid did have or adopted some of the strategies being recommended by the three authors. However, there was no one solution

fits all approach, but rather adoption of solutions that best fit the country's current socio-economic factors. What this has shown is that the strategies should merely act as a guiding principle and not a panacea.

## 5.7 Further lessons learned

One of the criticisms made against Tandon's exit strategy was that it lacked proper implementation steps and therefore made the strategy unattainable (Babeiya, 2011). This is also the case with both Moyo (2009) and Fee (2012), who did not state how the LDCs should start the aid reduction process. This weakness in the exit strategies may be addressed by this study by outlining further findings revealed during the country case study analysis. The evidence of the country case studies provided many recommendations about how LDCs should manage the exit process, that is,planning and implementation management. The country case studies emphasised how the countries managed the exit process; but they did not focus on what macro or micro-economic policies were adopted to supplement the financial gap and thereby complement the exit strategies. In addition, Heldgaar (2008) defined an aid exit formula that provided further tools that LDCs may utilise to support the aid reduction process. Heldgaar (2008) believed that this exit formula called a satisfactory aid exit, should form a basis for any country when making the aid exit decisions. The formula identifies six main factors that should be taken into account when embarking an on aid reduction process, namely: realistic timeframes, clear communication, proper planning, donors decision to exit, willingness on the recipient government to exit, support from other donors, and how to manage the changing role of the embassy.

The formula is stated as follows:
Satisfactory exit = F [t, C, DP, Gcap, Don, ΔEmb]
Where:
t = available time period to implement exit;
C = clear and consistent planning and communication;
DP = donor's decisiveness and persistence to exit;
Gcap = willingness and capacity of recipient Government;
Don = support from other donors; and
Δemb =changing role of Embassy.

These lessons learned will be outlined under three broad categories: the pre-exit phase; the exit management phase; the post exit phase.

### 5.7.1 Pre-exit assessment phase

Slob and Jerve (2008) recommends that each country should conduct a pre-exit assessment before starting the aid reduction process. This phase should typically entail conducting an assessment of the current economic state of the country by analysing the impact of aid reduction on the country as a whole. The assessment should further reveal what type of exit management process may be required, how the future cooperation between the donors and the recipient country will be and what policies should be adopted to supplement the financial gap (Slob and Jerve, 2008; Heldgaar, 2008). An important factor stressed by both Slob and Jerve (2008) and Heldgaar (2008) was the importance of giving the entire process sufficient time. Avoid a quick closure of the donor embassies. Once a decision has been made to exit the country, legal obligations and commitments made should be respected by donors, as walking out early on commitments may negatively affect the country (Heldgaar, 2008). The pre-exit assessment may also look at certain determinants for aid reduction: for example, aid reduction should only take place when the donors are assured that the projects or outcomes achieved will be sustained by the recipients (Heldgaar, 2008). In addition a study conducted by Hailu and Shiferaw (2012) showed that the likelihood of exiting from heavy reliance on aid increases significantly with the rate of investment. Therefore the higher the rate of investment the easier it is for a country to exit from aid. McPherson (2000) also recommended that the country's debt should be analysed and debt cancellation agreements agreed upon as LDCs cannot exit from aid unless they exit from debt. The pre-exit assessment therefore needs to assess what policies should be put in place to ensure a successful exit (Hailu and Shiferaw 2012).

Findings from these assessments will then inform the exit planning and management. Slob and Jerve (2008) found that pre-exit assessments contributed to a successful aid reduction process. However, in the case in the case for Botswana, South Africa and India, there was very little pre-exit assessment conducted, if it was not much was documented (Slob and Jerve, 2008).

### 5.7.2 Planning and Implementation Phase

The second phase that was recommended was the exit planning process, where comprehensive plans on how the exit will be implemented are drawn up. In an ideal world, exit strategies and plans should be clearly defined and made clear upfront at the time that

aid is being given and should form part of any country's foreign aid policy. These should be driven by the recipient government themselves to promote accountability, ownership and to also show willingness and capacity of the government. There were five main factors identified as being key when planning for an exit strategy.

First is the timing factor. One major lesson learnt was that proper and sustainable exit and implementation plans should be drawn up with realistic and flexible timeframes. These plans should be drawn up by the recipient countries and not donors, complying with one of the key factors agreed at the Paris Declaration of 2005. Participation of stakeholders was a good indicator for the success of the exit process. Most successful exits took about 15–20 years, as this allowed enough time for long-term planning and careful consultation of all stakeholders and good monitoring of results was key during this period. Good examples of a successful exit with high flexibility was seen in the case of Denmark exiting India and the Netherlands exiting Malawi. Contrary, Denmark's exit from Malawi which was done in six months, resulted in severe consequences (Heldgaar, 2008). Similarly, Green (2013) highlighted another key lesson arising out of the DFID exit from South Africa. DFID exited in an abrupt and unplanned manner, resulting in alienation of the recipient, which Green (2013) believes should be avoided. Green (2013) argues that exit decisions or discussions should be agreed upon in the initial phase, when the funding is being given.

Secondly, in cases where the exit decision is donor led, and may lead to negative consequences on the recipient part, donor coordination, harmonisation and alignment is important. Donor coordination is when another donor takes over from the one exiting in line with the Paris Declaration on Aid Effectiveness *(*Heldgaar, 2008). It is further recommended that the roles for NGOs, disaster and humanitarian funding should be given special attention (McPherson, 2000). However, McPherson (2000) cautions donors not to agree to scale back aid only to redirect their resources through other channels like NGOs as that does not help aid reduction;

Thirdly, communication was another critical element of the process. The way communication was handled and who was responsible influenced the outcome of the process. In most cases exit decisions and announcements came as a shock to countries, therefore cases like these should be avoided and all the relevant stakeholders should be involved from the onset (Heldgaar, 2008; Slob and Jerve, 2008).

Fourth important factor was institutional capacity. It was important to ensure that the programmes will continue with enough staff to manage the process. Lack of capacity and

early closures of the embassies was one element that should be managed and avoided (Slob and Jerve, 2008).

Fifth factor was the self –help principle propagated by McPherson (2000). He stated that exit from aid is not possible unless the government is prepared to abide by the self-help principle, i.e. the government provides more than 50per cent of the funding for any new projects going forward.

Lastly, it was recommended that tailor made approach should be developed for each exit, where good guidelines are formulated for managing the exit in line with the Paris Declaration on Aid Effectiveness (Heldgaar, 2008).

### 5.7.3 Post exit phase

The main focus of the post exit phase is to ensure sustainability of the exit process and also to ensure that the post aid relations are in place. This phase monitors the new types of co-operation created, which have proved to be difficult in some countries, e.g. Botswana (Heldgaar, 2008).

## 5.8 Conclusion

The main focus of this chapter was to conduct a brief analysis of countries that have successfully managed to reduce foreign aid, namely South Africa, India and Botswana. The aim was to fully understand what strategies these countries adopted to reduce aid and to then conduct a comparative analysis with the strategies being recommended by the three authors.

Botswana was regarded as one of the poorest countries in the world in 1966, but it had turned itself around by 2011, and had the highest per capita growth rate in the world (Acemoglu et al., 2011). Botswana started receiving foreign aid in 1966 and aid made up 60per cent of its budget; but by 2008, aid had reduced to 0.6per cent of its budget (Kerapeletswe et al., 2008). Botswana is one country that is said to have effectively utilised aid to develop its economy (Slob and Jerve, 2008). This was due to its excellent governance systems, strong institutions, little or no corruptions and a clear vision on how to achieve its government objectives. (Slob and Jerve, 2008; Carlsson et al., 1997). Three main reasons triggered Botswana's exit from foreign aid, namely: the graduation argument; over-

supply of aid; and lack of cooperation from the government in handling a project issue with Danish donors (Slob and Jerve, 2008). Clear comprehensive exit plans were drawn up once the donors announced their intentions to exit, these focused on how further inter institutional cooperation will be handled between the two parties (Slob and Jerve, 2008). Three main exit enablers were identified in Botswana's case, namely, pre-existing good institutions, excellent governance and policies that supported aid reduction were implemented (Fee, 2012; Moyo, 2009; Slob and Jerve, 2008).

Aid into South Africa started after apartheid ended in 1994, with the aim of promoting a stable society (Leshoro, 2012). Since 2005, South Africa received approximately 1 per cent of the budget government per year (OECD, 2011). Some of the main purposes for ODAs was to improve government systems, share best practices, innovation and improve service delivery (OECD, 2011). Aid formed a very small percentage of the government budget and was therefore not prioritised (OECD, 2011). South Africa was also known for being a donor to other African countries under the African Renaissance and International Cooperation Fund (Yanacopolos, 2012). Aid reduction was triggered by its income status as a middle income country and commenced in 2006, with donors still maintaining strong bilateral relations with South Africa after they exited. HIV/AIDs was the only programme that maintained donor funding (Ramkolowan and Stern, 2009).

India was the first and largest recipient of foreign aid, estimated at almost $55 billion as at 1992, making it 10 per cent of the public sector investment (Kamath, 1992). Three main triggers for aid reduction were identified for India, these being, the graduation argument, secondly was the reaction by the donors to India's nuclear testing and lastly it was India's own decision to reduce aid by asking the donors to leave. This led to donors leaving India at an accelerated pace, with the debt service ratio decreasing from 35.3 per cent in 2003 to 4.4 per cent by 2008 (De Groot et al., 2008). Just like in South Africa and Botswana, they followed the natural phasing out process, i.e. once a project was completed, they exited, whilst maintaining bilateral and institutional co-operation (De Groot et al., 2008).

Section 5.5. summarised the consequences that were experienced due to the reduction of foreign aid. For the three countries under study, no major consequences were experienced as they had the resources needed to replace foreign aid and secondly aid was a small component towards their national budget (Slob and Jerve, 2008). The main positive coming out of the whole process was that it enhanced accountability and local ownership (Slob and Jerve, 2008). However, all three countries suffered a lack of skills and ability to implement and manage to innovation programmes (Heldgaar, 2008).

Comparative analysis between the exit strategies being recommended and the ones adopted by the three countries was conducted and outlined in section 5.6. There was a clear alignment between the two strategies in the following areas: institutional development, pro-poor budgeting, and remittances, creation of employment and decent wages and bilateral relations with China. However, there were differences from other strategies, namely: open markets, domestic resource mobilisation, micro-financing and economic diversification. Botswana opened its markets, whilst India was a closed market until 1991. In terms of domestic resource mobilisation, South Africa and India seemed to be doing very well with their tax reformation and collection, whilst Botswana was still lagging behind. Micro-finance does exist in all three countries, but the evidence on the ground suggests that it does not work in all of them, and in some it is not a priority. In India, micro-financing is an integral part of the economy, whilst in Botswana and South Africa it has not worked and has therefore met with a lot of criticism. India and South Africa seem to have well diversified economies, whilst Botswana is still being criticised for being heavily reliant on its mining sector, which presents a risk, as seen in the global recession experienced in 2009, which affected the diamond market. All three countries still use aid for health and humanitarian disasters.

Lastly section 5.7, outlined the key general lessons learned regarding aid reduction. McPherson (2000) cautioned that lessons must be drawn or adopted carefully without assuming that what worked in another country can be easily implemented elsewhere, country specific factors must be taken into consideration. Seven main lessons were identified. First, a proper and sustainable exit plan should be drawn up with realistic and flexible timeframes (Heldgaar, 2008). Secondly, it was recommended that exit plans should form part of the initial aid negotiations and be part of the roadmap and not drawn at the end when a decision to exit is made. Thirdly, donor coordination and harmonisation is critical to ensure continuity should there be a need for it. Fourthly, communication is important at all levels, as how communication is handled influences the outcome of the process. A tailor-made approach on how to exit should be designed and it must be aligned to the Paris Declaration on Aid Effectiveness (Heldgaar, 2008). Institutional capacity is critical to ensuring a successful exit, and countries are warned about closing embassies too early. Lastly, governments must be prepared to abide by the self-help principle, whereby government provides more than 50per cent of the funding for any new projects going forward (McPherson, 2000).

In conclusion, even though, the analysis reviewed that the exit strategies being recommended by the three authors aligned with those utilised by the three case studies reviewed, it is important to caution that country specific conditions should be taken into account before adopting any of these exit strategies and no one single solution fits all.

# CHAPTER 6

# SUMMARY, RECOMMENDATIONS AND CONCLUSIONS

## 6.1 Introduction

Neo-classical theories paved the way for foreign aid to be enacted as a government policy in many countries. This led to the adoption of foreign aid as a policy at the Bretton Woods Conference in 1944. Foreign aid was categorised under three main areas, namely: official development assistance (ODA), which targeted LDCs; official assistance (OA), which targeted richer countries; and humanitarian aid. Various schools of thought embraced aid as an integral part of economic development, as contained in economic models such as the Harrod and Domar Models (1946), Rostow's stages of economic growth (1960), The Big Push Theory of Rosenstein-Rodan (1943 and 1961) and the Two Gap Theory of Chenery and Strout (1966). As a policy, foreign aid has gone through various stages of modification over the years, from the moment it was institutionalised in 1944 at Bretton Woods, to the Marshall Plan and Cold War Era in 1947, and then the Truman Doctrine of 1949, which ushered in the golden age period. The period 1955 to the 1970s was termed the golden age of development aid, as foreign aid flows grew substantially. By the 1970s and 1980s, foreign aid had still failed to alleviate poverty and the world fell into a recession. This era was named the lost age of development as the world faced an oil crisis and the world economy fell into a recession and debt crisis. This crisis was blamed on lack of political governance and democracy, and this saw aid in 1990s shifting focus towards governance, democracy and debt relief. With no clear and tangible results emanating from foreign aid in eradicating poverty, the United Nations believed clearer and focused goals were needed to tackle poverty alleviation and this saw the birth of the Millennium Development Goals (MDGs), making the 2000s the MDG era (Moyo, 2009). This ongoing modification of foreign aid as a policy was necessary as policy makers tried to address its failures and effectiveness expectations.

Throughout all of these transformation phases, despite the ineffectiveness of foreign aid, aid flows and dependency levels continued rising. The study presented the arguments from the two schools of thought on aid effectiveness, those that believed that aid was effective and the other who believed in the opposite. Popular economists like Sachs (2005), Stiglitz (2002), Burnside and Dollar (2000), and Hatemi and Irondoust (in 2005) all believed that foreign aid supported poverty reduction and growth with favourable conditions. In contrast

Friedman (1958), Griffin (1970), Griffin and Enos (1970), Weisskoff (1972), Bauer (1972), Boone (1994), Easterly (2006) Tandon (2008), Moyo (2009), and Fee (in 2012) all argued that aid had not achieved the desired impact on economic development, but rather encouraged corrupt governments, enriched the elite in poor countries, facilitated the importation of inappropriate technology and distorted domestic income distribution. These aid failures led to Tandon (2008), Moyo (2009) and Fee (2012), developing exit strategies that could aid LDCs reduce their dependency on foreign aid.

The main aim of these exit strategies, which are summarised below, was to provide a policy guideline and a starting point for LDCs, should they ever want to reduce their aid dependency levels. Policy alternatives that may assist in closing the savings and resources gap formed a critical aspect of these exit strategies, for example, domestic resource mobilisation, promotion of capital solutions and global trade. In the same manner, Institutional development came out as one of the most critical policy that should be in place if LDCs are to be successful in reducing aid volumes or amounts.

Despite these proposed exit strategies majority of LDCs were still dependent on foreign aid. This then raised the question as to why there was a slow adoption of these exit strategies. Various reasons could have been behind the lack of adoption of the exit strategies, for example, lack of feasibility or lack of enabling factors.

The aim of the study was to analyse the exit strategies proposed by Tandon (2008), Moyo (2009) and Fee (2012) within the context of the debates on the merits of foreign aid. The emphasis was to develop an understanding as to whether these strategies were feasible and easy to implement in LDCs in view of their economic circumstances. The analysis was done by conducting a review of the current literature on aid exit strategies with particular focus on the work of the three authors. The analysis was further supported by a review of three countries that had successfully managed to reduce aid, namely, India, South Africa and Botswana with a focus on the exit strategies that they used in the process.

A key limitation to this study was that no previous primary research exists that had assessed the effectiveness of these proposed exit strategies. The study used a comparative approach to analyse whether the different proposed exit strategies were feasible by considering the experiences of the three different countries. It also examined to what extent the proposed exit strategies matched and were aligned to the strategies used by the three countries.

The study found that the exit strategies recommended by Tandon (2008), Moyo (2009) and Fee (2012) were feasible and did provide a guideline on what policies could be implemented to enable an aid reduction transformation. Chapter 5 of the study highlighted the alignment identified between the exit strategies being proposed and the strategies adopted by the three countries under study. Institutional development, mind-set adjustment, pro-poor budgeting, creation of employment and decent wages were the exit strategies prevalent in all three countries. One may argue that the three countries under study had existing resources to finance the gap when aid was being reduced, which is not the case in most African countries, questioning the ease with which these strategies may be implemented. Without a doubt the reduction of aid is not an easy process, and the LDCs will in most cases not have the resources to support the process, but what these exit strategies may do is provide a policy guideline to kick-start the aid reduction process. For example, the exit strategies strongly recommended that strong institutions should form the basis of a successful aid reduction process, and usually provides that enabling environment for governments to mobilise the much needed resources to support their development agendas.

The exit strategies assisted in identifying key areas where countries should prioritise and stressed the importance of leadership to be committed to the cause once the project commences. However, one of the weaknesses that the study identified with the exit strategies was that it lacked the “how to”, how do countries then implement these strategies and where do they start? To address this weakness, the study developed a high level implementation approach which countries may adopt should they want to reduce aid using the recommended strategies. This three-step approach consists of: pre-exit assessment, planning and post implementation assessment. This approach may aid them in their transformation process and make the process manageable.

This chapter will therefore summarise the main view-points identified in the study. This will be done in four main sections, consisting of: section 6.2, which outlines a summary of the proposed exit strategies that were analysed. Section 6.3 summarises the main findings regarding the exit strategies with regard to feasibility, ease of implementation, customisation and implementation approach. Section 6.4 further outlines policy guidelines that LDCs could implement to assist in raising alternative source of funding to supplement the financial gap when aid is stopped. The conclusion follows in section 6.5 with the concluding remarks and recommendations for further research.

## 6.2 Summary of proposed exit strategies

Tandon (2008) believed aid had not achieved its objectives instead it had merely caused LDCs to incur more debt. He therefore proposed the following seven exit strategies on how LDCs could reduce this dependency: mind-set adjustment; budgeting for the poor and not the donors; the need to focus on employment and decent wages; domestic market creation and domestic resource mobilisation; the need to cut down government expenditure; institutional development and the enactment of national democratic projects that would prioritise aid reduction.

Similarly, Moyo (2009) proposed the following exit strategies with emphasis on financial instruments or rather ways to finance development: investing in capital markets; development of bilateral and trade relations with China; global trade for African economies; and, lastly, the importance of making banking available to the poor who had no access to the formal banking sector. Moyo (2009) went further and proposed a three-step approach on how to embark on this aid reduction journey; the proposed steps were: develop an economic plan; cut spending on non-essential items; strengthen institutions and increase accountability.

Fee (2012) on the other hand called for aid reduction, mainly due to donor fatigue and he put forward the following exit strategies, as a solution for LDCs to find other alternatives for funding: institutional development; domestic resource mobilisation; economic diversification; restructuring the foreign aid organisations to align more with the global fund structure. Lastly, he advocated the importance of self-help aid or what he called the matching concept, whereby the recipient of aid contributes the same amount to an initiative as does the donor.

As outlined in the study, the authors seemed to agree that the following policies were ideal for an aid reduction strategy: institutional development, mind-set adjustment, the need to change the aid organisational structures and the importance of formalising savings from the informal sector. However, differences were evident in their strategy recommendations: Moyo (2009) advocated trade liberalisation, trade relations with the Chinese, micro-financing and remittances; whilst both Tandon (2008) and Fee (2012) did not believe that these strategies were ideal for the struggling economies of most LDCs. The fact that there are differences amongst the authors, indicates the need for a careful consideration on the part of the LDCs on which strategies or policies to implement in their countries as there is no one solution fits all. The question of the proposed exit strategies' feasibility or ease of implementation forms the basis of this study and this will be summarised in the section below.

## 6.3 Summary of the main findings

This section will summarise the key findings of the study as well as lessons learned and recommendations from countries that have managed to reduce aid. There were five main findings, which are outlined below.

Firstly, the study found that the exit strategies were feasible. This is based on the fact that the three countries that had reduced aid used similar strategies in their aid reduction process. These were institutional development, mind-set adjustment, pro-poor budgeting, creation of employment, the importance of decent wages and bilateral relations with China. This finding therefore suggests that these exit strategies may be used as a policy guideline when countries want to embark on an aid reduction project.

Secondly, the study identified that implementation of these exit strategies may not be an easy process. This stems from the fact that the three countries that had reduced foreign aid had prevailing factors that enabled a successful aid reduction. These enabling factors are outlined below.

- Availability of resources that covered the gap that foreign aid left. Foreign aid formed a small percentage of these countries' budgets and therefore did not experience any major consequences when aid stopped as it was really an insignificant amount;and
- All three countries had well established institutions in place which was not the case in most LDCs rendering the aid reduction objective difficult to achieve.

This study therefore concludes that the adoption of these strategies may not be an easy process in an environment where these key enabling factors are non-existent, but requires careful consideration, planning and right balance of policies when the exercise is conducted.

Thirdly, the study found that there is no one solution or approach to aid reduction, therefore customization is key. This is evidence by the different policy approaches that the three countries undertook, for example, trade liberalization, micro-financing and remittances. It is important to take into account individual country factors and circumstances, as there is no one-size-fits-all solution. These exit strategies were not a panacea, but merely policy guidelines.

Fourth finding that the study revealed was that when aid was being given, there was no set deadline upfront as to when aid will stop, just like it was done in the Marshall Plan, this exacerbated the spirit of dependency as aid was accepted as part of their government's budget (Riddell, 2008). Setting up deadlines for aid reduction will force countries to develop and implement these exit strategies and find other sources of funding and ensuring that there are ready for an aid free season.

Lastly, the study also revealed that the exit strategies do not in most cases provide a clear roadmap on how the LDCs may kick-start the aid reduction process, i.e. where do they start from and how do they manage the process. Moyo (2009) did provide three key implementation steps on how to kick-start the process, namely: development of an economic plan; cut spending on non-essential items; strengthening institutions and increasing accountability. However, these were dealt with at a very high level and did not provide enough detail. Babeiya (2011) made a similar criticism against Tandon (2008) that the recommendations made were unattainable due to lack of proper implementation steps, they do not provide the "how to". Slob and Jerve (2008) also highlighted the importance of having a clear plan and implementation process. To address this gap, the study has outlined a recommended implementation approach which enhances and complements the exit strategies as part of further lessons learned.

## 6.4 Policy recommendations

This study has focused on the different exit strategies that the three authors recommended on how to reduce aid dependency. Some of these strategies were inherently policies that could be implemented to boost growth, whilst generating revenue for economic activities. This section, we propose further a number of key trade and domestic policies that LDCs may implement to generate domestic revenue and further reduce aid dependency. It is important that each country should follow its own growth path, taking into account its social and economic factors and coming up with its own combination of policies. These policy guidelines are outlined below.

### 6.4.1 Trade reform

Although the promotion of global trade in LDCs is faced with a lot of challenges and controversies, advocates for trade still believes that it has the potential to open up many opportunities for LDCs and improve their economic growth. Moyo (2009) alluded to the

same fact when she recommended trade liberalisation. Exports opens up new markets for local producers and the ability to earn foreign exchange (Ackah and Morrissey, 2005). Similarly, imports bring new technologies and innovations that increase efficiency in local production (Ackah and Morrissey, 2005). Therefore, trade policy reforms should be prioritized by all LDCs, so that they avail themselves of this type of opportunity. These reforms may include the following: relaxation or elimination of tariffs and export subsidies; removal of duties; changes in licensing and direct allocation of foreign exchange; reduction of market inefficiencies and regulations to encourage investment (Agbahey et al., 2017; Bienen, 1990). Benefits of trade liberalisation are not uniform across all countries; however, the evidence suggests that, with the right supporting infrastructure, Africa could benefit from it (Sandfilipo and Sundaram, 2018).

### 6.4.2 Improvement of the agricultural sector

The agricultural sector has been and will always be a critical source of income, food and employment in most African countries, as the majority of the population resides in rural areas (Veras, 2017). Agriculture contributes an estimated 32 per cent to Africa's GDP (Veras, 2017). For example, agriculture contributes only 2.5 per cent of South Africa's economy and yet it contributed 0.8per cent of the 3.1 per cent growth attained in 2017(South African Market Insight, 2018). Ethiopia is the world's fastest growing economy, with the growth being led from the country's agricultural sector, which employs approximately 80 per cent of the population (Gray, 2017).

However, the agricultural sector in most LDCs is riddled with many challenges which affects its productivity. There is a lack of irrigation, with only 5 per cent of arable land in Africa irrigated and the rest being dependent on rainfall: Asia has 38 per cent of its land under irrigation (Veras, 2017). Veras (2017) further stated that most African farmers do not have adequate fertilizers, mechanization and pesticides.

Therefore, policies to boost infrastructure and agricultural development are essential to facilitate the much-needed structural economic transformation in LDCs. (United Nations, 2017). Initiatives by governments to modernize and improve agricultural production could eliminate the problem of food insecurity and provide the most basic needs of the mass population of Africa (African Institute for Development Policy (AFIDEP), 2016).

### 6.4.3 Tax reform

Tax reform has been one of the trade policies recommended by most development organisations like the IMF and OECD. McNabb and Boucher (2014) agrees with this and argues that taxes do make a difference, but countries need to be clear as to which taxes, where and how much they should implement in their economy, as some taxes may distort the economy. For example, the IMF recommends an increase in Value Added Tax (VAT) for most LDCs. Africa has potential tax revenues that are not being collected. It is estimated that in 2017, revenue contribution emanating from taxes was at 3.1 per cent of Nigeria's GDP, in comparison to the USA (25.4 per cent) and the UK (32.9 per cent) (Yusuf, 2017). With the right tax reforms, it has been predicted that countries in sub-Saharan Africa could increase their tax revenue by 5 per cent of GDP (Monteiro, 2018). These initiatives may include: eliminating tax exemptions, but making sure that the poor are protected; and ensuring compliance by all tax payers; the use of smart information systems (IMF, 2011). To ensure proper implementation of these tax reforms, there needs to be government commitment and buy in from relevant stakeholders (Akitoby, 2018).

### 6.4.4 Promotion of Small Medium Enterprises

Small Medium Enterprises (SMEs) have a significant and effective role to play in boosting economic development as stipulated by most economic commentators. SMEs in India, are expected to contribute 20 per cent to the countries' GDP by 2020 (Press Trust of India, 2013). A recent study conducted in 2017, in Kenya indicates that SMEs forms 98per cent of all businesses in Kenya, creating 30 per cent of the jobs annually and contributing 3per cent of the country's 6.4per cent GDP growth (African Review, 2017). A lot can be said about the significant benefits that SMEs could provide; however, there are various constraints that prevents them from realising their full potential and impacting the economies as they should. It is important therefore that SMEs be supported in a number of ways by their respective governments in creating a conducive legal and policy environment that will enable them to thrive. These may include: easy access to finance, VAT exemptions, lower interest rates for capital investments, adequate infrastructure, for example, the transportation and telecommunications, easy access to global markets, provision of training to enhance their skills (Beyene, 2002)

### 6.4.5 Technology and infrastructure development

A rise in productivity has been experienced recently in most developing countries as well as some African countries. This has mainly been driven by the improvement in innovation, science and technology in how goods and services are produced. This rise in productivity has had a knock on effect on economic growth (Attah-Mensah, 2015). However, the majority of LDCs have poor infrastructure and low levels of investment in technology which has robbed them of the global economic opportunities and productivity. To achieve a sustainable economic growth, LDCs should implement the appropriate science and technology policies. These activities may include, investment in research and development, encourage science and technology within schools and tertiary institutions, incentivise private sector to invest in research and development activities.

### 6.4.6 Good governance

Good governance is central to a countries' economic growth and promotes and helps them build strong efficient institutions. A study conducted by Han, Khan and Zhuang (2014) found that good governance has a positive correlations with higher levels of per capita GDP and higher rates of GDP growth over time. Similarly, various econometric studies have found that positive relationships exists between market enhancing governance indicators and economic development (Kauffman et al., 1999 and 2005; Knack et al., 1999). Fayissa and Nsiah (2013) found that governance contributes to the differences in income per capita between the developed countries and LDCs.

Strong institutions promotes effective service delivery, facilitate private sector growth and builds the trust of its citizens (The World Bank, 2018). It also ensures a corruption free society, therefore good governance should be a top priority on each government agenda (The World Bank, 2018). The World Bank has designed five principles or areas that may form as policy guidelines when countries embark on governance transformation projects. These are: strengthening public policy processes, promoting effective resource management, improving government departments service delivery, enhancing the public-private sector interface, and analysing and improving the underlying drivers and enablers of policy effectiveness (The World Bank, 2018). Sangita (2002) believes that it is vital that when government undertakes such reforms, effective communication to the relevant stakeholders should be an important factor. He further states that the need to reform and the approaches to be taken and the expected benefits should be emphasised to all to ensure

buy-in and success of the transformation project. This study believes that the World Bank recommendations may be used as a guideline for LDCs to embark on a governance transformation project.

### 6.4.7 Incentives to encourage FDI

Foreign direct investment (FDI) brings with it technological improvements, assists in human capital development, promotes trade collaboration, assists in developing a more conducive business environment that enhances enterprise development (OECD, 2002). All of these are what most LDCs need to see higher levels of economic growth, which is key in reducing aid dependency. It is therefore imperative that LDC governments should embark on projects to attract and incentivise FDIs into their countries. Stable political and business environments are key in ensuring FDI flows and should be high on most government's agendas to establish a transparent, broad and effective enabling policy environment for foreign investments (OECD, 2002; Cheadle, 2016).

### 6.4.8 Reduce the cost of remittances

UNDP (2016) states that remittances averaged about $21.8 billion over the past decade, contributing as much as 10 per cent to the GDPs of countries like Nigeria and Senegal. As advocated by Moyo (2009) and Fee (2012) remittances could contribute to a countries' revenue if implemented and managed properly. However, the cost of sending remittances home in most LDCs is the highest in the world. This could be a quick win and easy to implement policy in most LDCs (UNDP, 2016). For example, the implementation of the anti-money laundering regulations have hurt some African countries, as banks stopped sending money to certain African countries, the risk management of such initiatives by African countries to minimise the impact on their economies could be one of such initiatives to continue encouraging remittances (UNDP, 2016).

Implementing these policies is not a panacea to economic development and revenue generation, but merely a guideline. It is important for countries to identify the right and best policy combinations ideal for their economy, taking into account the prevailing conditions and factors, as no one solution is suitable for all.

## 6.5 Conclusion

The case for an aid free world has undoubtedly been demonstrated, LDCs no longer need to be convinced that foreign aid is not good for their economies and the sooner they reduced their reliance on foreign aid the better. Moyo (2009) stated that Africa should be aiming for an aid free world as Africa does not need aid. This is supported by a report released by the Global Justice Now, which states that there is more money flowing out of Africa than what comes in, for example, $162 billion was received in Africa but $203 billion was taken from the continent, either through multi-nationals expatriating their profits to a tax haven or for costs related to climate change mitigation (The Global Justice Now, 2017).

Africa has the resources required to reduce its poverty levels but lacks the leadership and will power to get itself from the poverty trap to a poverty free world. Africa is endowed with extensive resources, for example: South Africa's mineral wealth is estimated at $2.5 trillion; the Democratic Republic of Congo's mineral wealth is estimated at $24 trillion; Nigeria is Africa's largest oil producer, but half its population is without electricity. Therefore, to say that Africa needs aid is a myth (The Global Justice Now, 2017).

As stated above, Africa has the necessary resources to finance its development agenda, and therefore does not need aid. In addition, feasibility of the exit strategies has been established, providing a way to LDCs on how to reduce aid dependency. Why then is there still a high dependency on foreign aid? In an effort to answer this question, this study unearthed a fundamental factor that may have contributed to the slow reduction of foreign aid, and that is the importance of mind-set adjustment and commitment to the development cause for Africa.

All three authors agreed on the importance of mind-set adjustment (Tandon 2008; Moyo 2009; Fee, 2012). Africa will only change when its inhabitants changes its mind-set and develops a positive attitude and belief in themselves (The African Courier, 2017). For these exit strategies to fully be realised the entire inhabitants of the African continents needs to be involved in the mind-set change process where collectively they unlearn, relearn and un-think and rethink the negative dominant thoughts emanating from the colonial past (Mnisi, 2019). It is only through transforming the current leadership through mind-set change that Africa may overcome its challenges of corruption and weak governance which hugely affects its ability to reduce aid and achieve a sustainable economic growth (The African Capacity Building Foundation, 2017).

South Africa, India and Botswana have demonstrated that it is possible to reduce foreign aid. One may argue that these countries had the resources to supplement the financial gap and the percentage of foreign aid within their budget was not significant. However, Rwanda was one of the highest recipients of aid, but it has managed to reduce it without the buffer of resources that the other three countries had. In 1994, Rwanda's economy was destroyed after the genocide, leaving the country in need of an immense economic reformation Hutt, 2016). Under the leadership of Paul Kagame, Rwanda has managed to achieve the fastest growing economy in central Africa - about 8 per cent per year between 2001 and 2014 (Hutt, 2016). Poverty levels have reduced from 57 per cent in 2005 to 45per cent in 2010 (Hutt, 2016). Even though Rwanda still has about 40 per cent of its budget being funded by donor money, its leadership is committed to changing this. In 2016, the president of Rwanda requested for solid deadline to be set for foreign aid to stop (Ngabonziza, 2016). President Kagame further stated that what Rwanda has achieved is not a miracle, nor is it impossible elsewhere, it is simply due to the commitment of an entire nation and the political will of its leadership (Rwanda Podium, 2018).

Having taken all these findings into consideration, this study recommends that direct research on the effectiveness of the exit strategies proposed and the best implementation approach thereof be conducted. Secondly, further research should be conducted on how to change the mind-set of African leaders and its citizens as a whole. The research should aim to address the following key matters: how to change Africa's mind-set from dependency mode to a self-sufficient continent; how to make Africans believe in themselves and make use of the numerous minerals and resources with which it is endowed. Finding solutions to these matters is not the answer to Africa's woes, but they will add an extra piece to the puzzle of solving Africa's development.

In conclusion, reduction of foreign aid is an attainable objective by any LDCs once they have made the decision and stays committed to the cause. The exit strategies recommended by the three authors provides an invaluable policy guideline to support that cause. However, reducing aid is a process rather than an end and it should not be under-estimated nor rushed, it is important not to throw the baby out with the bathwater, a slow transition is recommended (Fee, 2012). Key to this aid free world is mind-set adjustment by all stakeholders involved.

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