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Research Article

Foreign aid to Africa after the global financial crisis: A consideration in retrospect

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ABSTRACT

Several projections were made during and after the Global financial crises of 2007-2009 about the continuity of foreign aid to Africa.Some opined that the financial crises will reach Sub Saharan Africa via the decline of foreign aid as well as other financial transfers such as remittances and Foreign Direct Investment. It is on this premise that this study examined the flow of foreign aid to Africa in an effort to appreciate the trend before, during and after the Global financial crisis. The study used trend charts and the Bai-Perron multiple structural break test as well as the Chow test to analyse data sourced from the World Bank Indicators. The results show that, though Overall ODA dropped in 2007, it consistently increased up to 2013 by 25%. The structural break test shows that the trend of ODA has not significantly changed as a result of the Global financial crisis for; low, lower middle, higher middle and Sub Saharan countries as a whole. The result further shows that ODA to low income countries were higher than those of lower middle income countries which was equally higher than higher middle income countries. ODA to the agricultural, educational and economic infrastructural sector all increased after 2009. It is only ODA to the health sector that dropped significantly. The study concludes that Foreign aid to Africa has not declined, but rather improved in most cases. It therefore commends the efforts of aid donors and emphasizes the complementing role of foreign aid to Africa.

Keywords: *Foreign Aid; Financial Crisis; Africa*

1. INTRODUCTION

Official development assistance (ODA) or foreign aids by government and multilateral institutions has grown throughout the post-World War II period and has as its main objective, not only to provide food for nations that are on the brinks of starvation but also promotion of welfare and economic development of nation states. Sub-Saharan Africa (SSA) is one of the leading recipients of ODA globally when we compare them with other regions in the developing world (Alden et al., 2008). The idea behind ODA or the foreign aid-growth links grew out of the Harrod –Domar growth model. The model which was established by Chenery and Strout (1966), identified three gaps or constraints to economic growth of the less developed countries (LDCs) in which foreign assistance/aid is necessary to fill- the savings gap, the Trade balance gap and the Fiscal gap (Pohwani, Khoso, & Ahmed, 2019). Simply put, poor countries suffer from low levels of savings, due to poor investment behavior and large import bill, and finally, poor countries lack the capacity to increase internally generated revenue (IGR) to meet the desired level of public spending. Official

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development assistance therefore plays an important role to fill these gaps in an effort to promote sustainable growth and development for relatively less privileged countries.

It is against this background that Africa has found itself on the trap of ever looking unto ODA for sustenance, thus the “Feeding Bottle Hypothesis”. It is arguably too, that even where increases are recorded in other areas of inflow, example, foreign direct investment (FDI) and other forms of inflow, ODA still remains an important source of savings to be reckoned with in Sub-Saharan Africa. Unfortunately the argument that favors relying on aids to promote development has been on for many decades. Reinert (2007), calls it “palliative economics”, where instead of attacking the source of poverty from inside through production system- which is what development is – the symptoms are addressed by throwing money at them from the outside(a form of helicopter money). Others like (Collier P, 2006; Auty, 2007;) has likened aids to a ‘rent’ and sees recipient countries as likely to fall prey to ‘Dutch disease’ because of their inability to diversify beyond cheap sources of income. They further argue that aids increases capital flight through- corruption, volatility, and public investment routes. They went further to say that African countries should improve to grow their economy through gross national product (GNP).

Whereas, this proposition is possible through domestic savings and other “inward looking” policies, in Africa they are historically rare. “Often the most rapidly growing economies have been driven by an external engine”(Moon and Dixon,1993). For example the ‘imperialist industrialization’ of Britain, France and Germany were based on the principles of ‘out-sourcing’. Indeed, the recovery of Europe, Japan, and Korea after the World War II could not have been possible without the ‘Marshall Plans’. Again, the ‘Asian Miracle’ also underscores the importance of FDI and ODA at least in the early levels of developmental stages. Therefore the aid ‘pessimism’ of the 1990s which was based on cross-country growth regression analysis that has been questioned on technical grounds may have to be revisited (Roodman, 2008; Karras, 2006; Minoiu and Reddy, 2006). The pro-aid school of thought, insist that aid as a non-market and concessional form of finance, if properly and effectively utilized can become catalyst for facilitating technological adoption, developing infrastructure and enhancing dynamic linkages.

Though the world has experienced financial crisis in 1970s and 1980s, yet the financial crisis that originated in United States of America in 2007, could be likened to the great depression of the 1930s. In US it gave rise to assert depreciation, rising unemployment, the closing of major businesses which affected economic growth. Imperceptibly, globalization has interlinked world’s economies, such that any economy could be affected through international trade of cyclical fluctuations in another country; thus, the US experience became a global phenomenon and eventually led to some industrialized countries entering recession. Nevertheless, the perception held by many then was that Sub-Saharan African economies may not have been affected by this trend, perhaps due to the favourable average growth above 5 per cent per year they were experiencing at this time. Also, the limited depth and low integration of their financial systems with the U.S. and European capital markets appeared to be sheltering them – so the reasoning went (Allen and Giovannetti, 2010). According to the African Development Bank, “few banks and investment firms in Africa had derivatives backed by sub-prime mortgages. No difficulties have been reported on African sovereign wealth funds" (African Development Bank, 2009a). As financial crisis persists and more events continued to unfold, this perception that Africa is insulated changed especially as economic-weak and fragile countries in Sub-Saharan Africa (SSA) became vulnerable to trade shocks.

It becomes imperative to examine ways Sub-Saharan Africa has been affected after the global crisis. Foreign aid might not have been one of the key instruments in the global crisis, but it is common knowledge that the crisis propelled economies to focus inward and consequently reconsider external assistance like aid. The United States in particular actually outsourced to sponsor its quantitative easing strategy that saw her out of the financial crisis. Many African economies are however, vulnerably bound to experience downturn in case of declining foreign aid flows; particularly those that are not natural resource exporters. FDI, private sector financing, and even ODA tend to follow donor countries' economic cycle. The mechanisms through which the crisis could affect Africa therefore include-direct effects; stock markets, tighter financing conditions overseas (borrowing from advanced economies), and FDI: while indirect channel may include; remittances (additional revenue streams such as tourism and remittances from African workers abroad are also expected to fall), exports/imports (contraction in global trade), and ODA. When organization of Economic Co-operation and Development (OECD) lowers their aid to Africa, it comes with potential damaging effects. Examining the trend of foreign aid to sub Saharan Africa before and after the financial crisis is therefore what this paper intends to investigate.

2. LITERATURE REVIEW

Foreign Aid are flows provided by official agencies and governments to countries and territories on the Development Assistance Committee (DAC) list of ODA recipients and to multilateral institutions which are aimed at promoting economic development and welfare of the recipients. These flows are usually concessionary in nature and include at least 25% of grants. The list of ODA recipients is constantly updated and there are currently 150 developing countries with per capita income of below $11. Many expenditure flows from developed countries to developing countries are excluded from the list. For instance, expenditures on military equipment or services are excluded though cost of using donor armed forces discharge humanitarian aid is included. Nuclear energy programmes only for civilian intentions are included while those for military and other purposes are excluded. Cultural programmes that promote the culture of recipient countries are included while programmes that enhance the image of donor countries are excluded.

What are the motives behind foreign aid? Could it be humanitarian, economic, political and or other variables? Accordingly, Dudley and Montmarquette (1979) identified three major donor motives. First, political reasons was advanced as the major reason for advancing aid as the recipients are expected to support donors and this widens the donor's influence in international politics. Next, advancing foreign aid is often an avenue of expanding economic interest of donors as foreign aid are often granted under conditions that may coerce recipients to trade more with donors. Last, which is the usual reason often advanced, portrays the altruistic nature of foreign aid which promotes development and welfare of recipients.

2.1. Theoratical Background

A number of theories have been put in place to discuss the aid-growth nexus especially following the classical economists believe in the importance of capital as well as the success of the Marshall Plan in the economic reconstruction of Europe during the inter-war period. In this, debate on aid effectiveness has remained a topical issue in the disciplines of development economics and development studies. Notable development theorists such as Arthur Lewis, Gunner Myrdal and Ragner Nurske drew sufficiently from the Harrod (1939) and Domer (1946) and the 'two-gaps' model of Chenery and Strout (1966) to justify the place of foreign aid in the growth and development of newly independent countries.

Traditionally, the Harrod-Domar approach to growth perceived investment as critical to economic growth, to the extent that the shortage of savings required for investment in developing economies was seen as the greatest limitation to economic development (Moreira, 2005). It follows that developing countries are constrained by low per capital, thus, have limited capacity to generate sufficient savings for investment. Chenery and Strout (1966) extended the original Harrod-Domar model to incorporate the importance of foreign exchange using the two-gap approach. The main idea offered by this model is that developing economies are constrained by both savings and trade (or foreign exchange) gaps in their quest to achieve their desired growth rates. The model contends that the savings-gap and the foreign exchange gap are distinct and independent limitations to economic growth in developing economies.

The savings gap arises in the form of balance-of-payment deficit that results from short fall in savings required to invest at a level that would enable the attainment of the desired economic growth rates while the foreign exchange gap results from the excess of imports over exports which indicates that a country is demanding for more resources than it supplies (Kolawole, 2013). This model can be expressed using the identity: investment - savings (I-S) gap and imports – exports (M-X) gaps. Chenery and Strout are of the strong view that foreign aid is a means of covering these gaps, after which attainment of desired economic growth target in developing countries will be feasible. Therefore, without the inflow of foreign aid and foreign direct investment, a country will have slow rate of growth with inept use of available domestic resources such as labour and natural resources. More so, Kolawole (2013) argues that the amount of foreign aid required to bridge these gaps depends on the wider gap at any given time. That is, if the savings gap is wider than the foreign exchange gap, the economy is described as having savings constraint. On the other hand, if the foreign exchange gap exceeds the savings gap, the economy is said to be facing a foreign exchange constraint.

However, these theoretical justifications for the need to seek for foreign aid have been at various times criticized, because of the poor performance of aid in Sub Saharan Africa in particular. Sindzingre (2015) argues that the challenge on aid effectiveness and impacts on economic development emanates largely from studies on Sub Saharan Africa since 1960s during which developing economies in East Asia started achieving high growth rates and stopped receiving foreign aid. This may not be unconnected with the submission of Chenery and Strout that aid effectiveness in accelerating growth and development is dependent upon the adsorptive capacity of the receiving country to harness the gains from the aid. In view of this, Mbah and Amassoma(2014) argues that the capacity of a country to achieve high growth rate through foreign aid depends on several factors such as existing infrastructure, available skilled labour and sound institutions and governance. However, there exists a general consensus that foreign aid improves welfare and in some cases enhances growth.

2.1.1. Epirical Evidence

Empirical results on the impact of foreign aids on economic growth generate mixed results; while some studies found no positive impact of foreign aids on economic growth; others found positive and significant impact. There are studies that found varying impact at macro and micro level, resulting in macro-micro paradox of foreign aids on aid. Several reasons have been adduced for these. First, the type of data used can result to varying results. Most importantly, the growth model used is also a factor in determining the effectiveness of aids.

In other to correct these lapses, Durbarry, Gemmel and Greenaway (1998) examined the impact of aids on 58 developing countries between 1970 and 1993. The study used augmented Fischer-Easterly growth model so as to account for the effect of macroeconomic stability and policy distortions on the effectiveness of foreign aids. For robustness, the study incorporated augmented Barro model which includes other conditions for growth such as initial income levels, human capitals etc. Employing a two-way fixed effect model which was estimated using least square dummy variables, the study found positive and significant impact of foreign aid on economic growth using cross-sectional data, panel data and regional estimates. The study concluded that foreign aid benefits developing countries under the condition of macroeconomic stability and that the size of foreign aids matter. Too low or too much foreign aid is detrimental to growth while the optimum size of foreign aids was found by the study to be between 40% and 45%.

In a similar study using 85 developing countries between 1980 and 2007, Roodman (2008) examined the effects of foreign aid on the economic growth of developing countries by examining the relationship between foreign aid and per capita income. Using production function in which foreign aid is an input together with domestic capital and labour, the study estimated the modified production function using panel least square estimation method. The findings of the study are mixed. For instance, the study found that foreign aid had negative and insignificant impact on per capita GDP in 1980-1989; 1990-1999 and 1980-2007. It had positive and insignificant impact in the period between 2000 and 2007. When regional estimates are taken into consideration, the study recorded adverse effects on three out of four of the regions examined; Africa was the only region that recorded positive impact and this was explained by the authors that it was the region that received the highest amount of foreign aid in the review period. When estimated according to varying income level, the study found positive effect on three out of four different income levels. It had negative effect on per capita income low-middle income countries.

Moreira (2005) examined the macroeconomic impact of foreign aid of 48 developing countries, with an aim to resolve the micro-macro paradox. Using data from 1970-1998 which was divided into 6 sub-periods and employing Arellano and Bond's type Generalized Method Moments method (GMM) of estimation. Some of the preliminary findings were that the cause of the paradox in the aid-growth studies is due to varying econometric methods used in previous studies. The study found that increase per capita growth as a result of one percent increase in aid to GDP ratio ranges between 0.17% and 0.14% in the short run depending on the regression. While aid effectiveness on per capita growth in the long run ranges between 0.34% and 0.43% in the long run.

Again, Fatima (2014) examined the effectiveness of aid in enhancing economic growth in Pakistan between 1980 and 2012. The correlation result shows that growth rate of real GDP per capita was negatively correlated to ratio of aid to GDP. The OLS showed a positive relationship though with an insignificant impact on economic growth. Moreover, the result of the OLS showed very low fit as the R2 was low at 33%. To correct for these, the study applied ARMA model and found that aid effectiveness was about 50%. This study confirmed the study by Moreira (2005) that methodological and econometric issues are at the center of the disparity in most micro and macro studies.

Minoiu and Reddy (2009) assessed aid-growth relationship using a larger dataset, 1960 to 2000 for a sample of developing countries. Their findings are similar to findings of Moreira (2005) that shows that when different econometric estimation techniques such as OLS, 2SLS and GMM were applied, developmental aid impacts positively on long run growth.

There are also studies that proved that foreign aid has negative impact on growth and development. Lohani (2004) is one such study of 120 developing countries for years 1975, 1980, 1985, 1995 and 2001. The study assessed the impact of social aid on human development. Social aids are those foreign aids directed at development indicators such as education, health, sanitation etc. The OLS result show that lagged values of social aid had significant negative effect on human development. The author explained that this negative effect may be due to statistical bias caused by reserve causation. That is, foreign aid is usually linked to low human development because countries with low human development usually attract more aid.

Study by Chenery and Carter (1973) also show evidence of mixed impact of aid on development performance of 50 countries within the period 1960 and 1970. Using the 2-gap model developed by Chenery and Stout, the study found positive impact for Thailand, Taiwan, Iran, Korea and Kenya; negative impact for Ghana, Tunisia, Ceylon, India, Colombia, and Chile and neutral effect on the rest. While, Knack (2000) used cross-country data of developing countries and also found a negative effect on growth through aid's negative effect on institutional quality, governance, rule of law and promotion of corruption.

Just as evidence has shown that economic, political and social conditions in the receiving country affect aid-effectiveness; it has also been proven that such conditions in the donor country also affect the effectiveness of foreign aid. One of the major consequences global financial crisis was that most of the aid funding countries that were badly affected by the financial crisis had to put attention inwards to revive their ailing economies by creating jobs, revitalizing weak firms and strengthening the financial sector. The outcome of this decision is that they played down other expenditures like aid to other countries. Dang, Knack and Rogers (2010) reported that income of developing countries fell by about 7% between 2007 and 2009 as a result of the financial crisis. Empirically, Dang, et al (2010) also found that aid flow from 24 donor countries between 1977 and 2007 fell by an average of 20% to 25% as a result of the banking crisis. This result could be appreciated as one of the fall-out after ten years of the banking crisis.

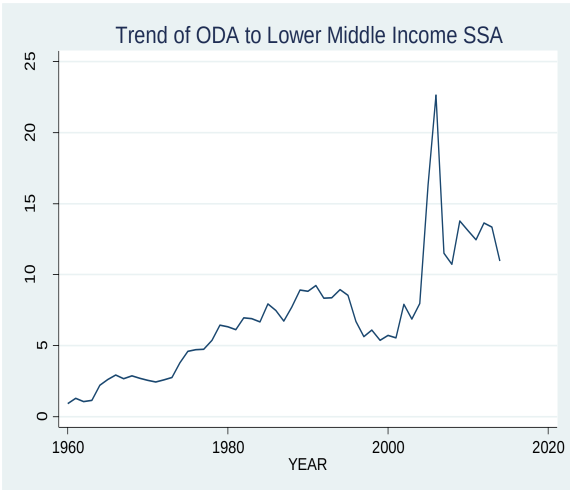
A similar but more robust study was conducted by Das and Dutta (2012) to show the impact of the financial crisis on foreign aid and how this impacts on the economic growth of least developing countries. The study used data from 17 OECD-DAC donor countries and 53 LDCs from 2004 and 2010 and employed static panel and dynamic panel GMM estimators which were robust to different test to find that the global financial crisis declined aid flow to LDCs. This negatively reduced economic growth through several channels.

Summarily we can deduce from the empirical literature that Africa was not completely insulated from the global financial crises. There is ample evidence that Africa did not suffer aid loss significantly, nevertheless there was an impact. What it presupposes is further examination of the impact of the financial crisis on Africa would not be a futile exercise. The conflicting results are overwhelming.

3. TRENDS OF FOREIGN AID TO AFRICA

3.1. TRENDS OF ODATO SUB-SAHARAN AFRICA BY INCOME CATEGORIES

This section explores the dynamics of Official Development Assistant in Sub Saharan Africa. It contains graphical representations of trends of Official Development Assistant to low income countries, lower middle and upper middle countries in Sub-Saharan Africa.



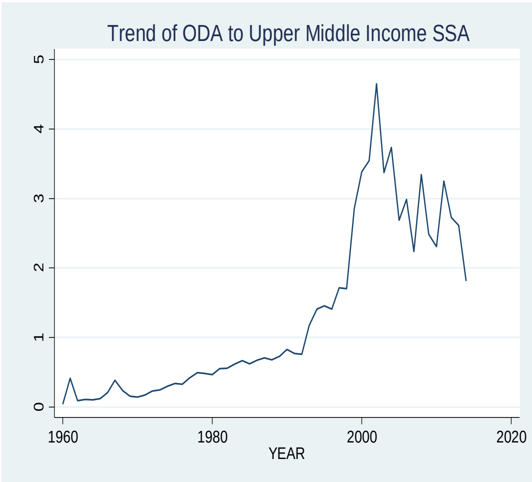


Fig. 1. Trend of ODA to low, lower middle and upper middle countries in SSA

Source: Author's computation figure

In Fig 1, ODA into low income countries shows an increasing trend with a significant decline in 1999. Starting with $1.9bn in 1960, it rose to about $12.7bn in 1997, dropped to $11.35bn in 1999 and then rose again to $23bn in 2006, and to $25bn 2009. It further rose to $27bn in 2011 but dropped slightly to $26bn in 2014. The trend of ODA to lower middle income countries is equally increasing but relatively gentler when compared to that for Low income Countries. Starting with $0.9bn in 1960, ODA to lower middle income countries in SSA rose sharply to $9.23bn in 1992 and similarly dropped to a 20 year low of $5.4bn in 1999. It then rose to $16bn in 2005 and further to $22.6bn in 2006, but dropped sharply to $11.5bn in 2007 and rose slightly to $13.8bn in 2009. However, it dropped to $10.9bn in 2014. On the other hand, beginning with $0.04bn in 1960, ODA to upper middle income countries grew sluggishly throughout the period before 2002 in which it recorded its highest value of $4.65bn in 2002. It then fell slightly to $3.3bn in 2008 and $2.4bn in 2009 but decreased further to $1.8bn in 2014.

Meanwhile, the trend for all three categories of income groups confirms that low income Sub Saharan countries receive the most foreign Aid, followed by lower middle and then higher middle income countries as expected. This is in accordance with international expectation and objectives.

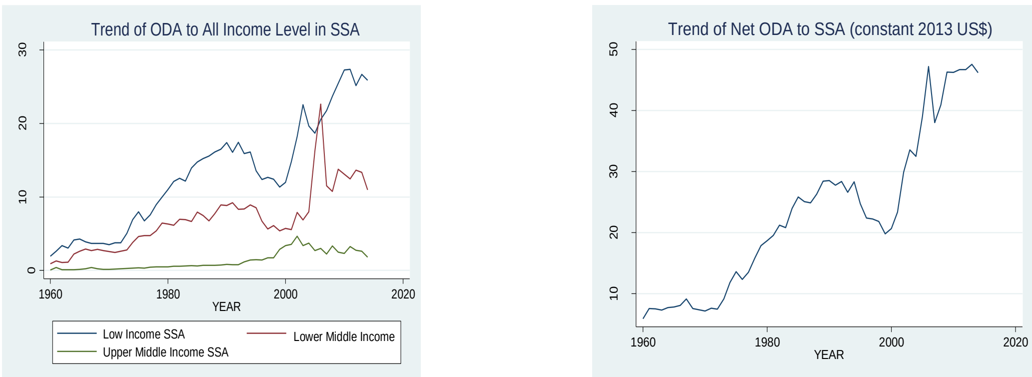


Fig. 2. ODA to all Income Level in SSA

Source: Author's computation

On the other hand, in Fig 2, Net ODA to SSA was about $5.9bn in 1960, rose to 9.18 in 1967 and then dropped to 7.18bn in 1970. It then rose to point of $47.2bn in 2006, decreased to $38bn in 2007 and then grew again to its peak in 2013 at 47.6bn. It however slightly dropped to 46.2bn in 2014. Interestingly, overall ODA to SSA increased consistently from 2007 to 2013, and then a slight fall in 2014. This shows that the idea of ODA falling after the financial crisis remains a fluke. There might be differences when country specific analysis but the overall ODA to SSA has increased considerably since 2009 to 2.8% in 2013.

Observably, the trend suggests there is a significant increase on the aid that goes to poorer countries than the aids that go to more advanced countries. Again, we can also observe that there were some slight decreases after the financial crisis, however, to ascertain whether this decrease is significant or not, this study performs structural break tests. The study employed the Bai Perron structural break test and the Chow test to investigate if there is any significant difference in the trend after the Global financial crisis. They were both used for their independent peculiarities; while the Bai-perron test offers opportunity to test for several break periods as there exist, while the chow test checks if a particular period is a structural break in the trend.

Table 1. Structural break Tests by Bai-Perron and Chow for of ODA.

Description	Multiple Break Point Test			Chow Test		
	Sequential Break Dates	F-Statistic	Bai-Perron Critical Values	Break in 2007?	Break in 2008?	Break in 2009?
Low Income Countries	1981	110.0052*	8.58	None	None	None
	2003	105.5017*	10.13	None	None	None
	1973	23.25992*	11.14	None	None	None
Lower Middle Income	2005	80.17284*	8.58	None	None	None
Countries	1978	65.47778*	10.13	None	None	None
Higher Middle Income	1999	237.2133*	8.58	None	None	None
Countries	1991	28.27232*	10.13	None	None	None
	2007	18.78101*	11.14	None	None	None
ODA to all Sub Saharan	2002	101.0853*	8.58	None	None	None
Countries	1979	130.7769*	10.13	None	None	None

*Multiple Break Test Options: Trimming 0.15, Max breaks 5 and * is Significanceat5%*

In Table 1, the structural break test results show that there is no significant structural break in 2009 which is generally considered as the end of the Global financial crisis. The Multiple break point tests all significant structural break tests are before 2007 for low and lower middle income countries as well as overall ODA to all Sub Saharan Countries. One of the significant break point for higher middle income countries is 2007, but the Chow test shows that in 2007 there was no significant structural break.

5.2 Trends of ODA to Sub-Saharan Africa by sectors.

The study further analysed ODA to SSA by sectors; agriculture, education, health and economic infrastructure. First, the paper analysed the trend of ODA to SSA agricultural and education

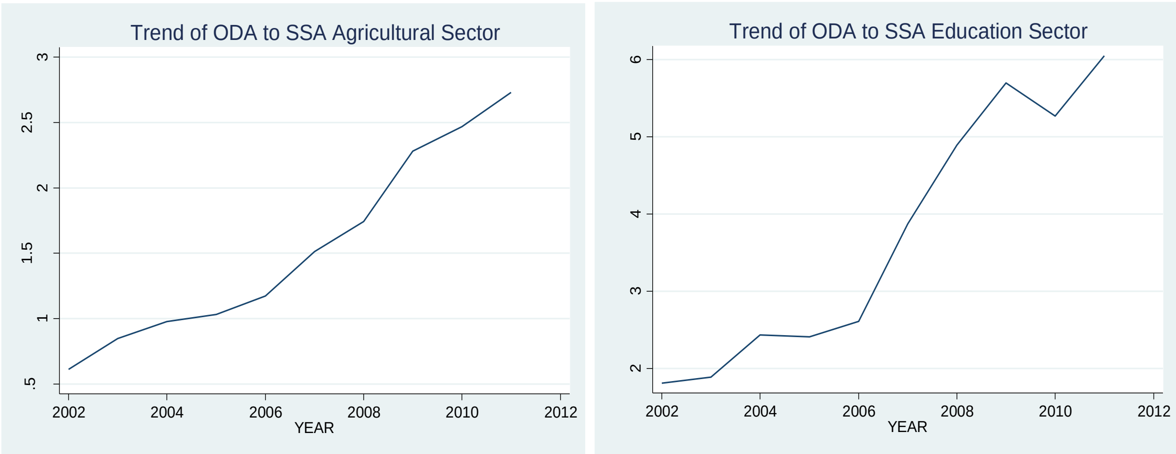


Fig. 3. ODA to SSA for Agricultural and Education Sector

Source: Author's computation

Fig. 3 shows that the agricultural sector of SSA received about $0.6bn development assistance in 2002. This rose consistently to $2.3bn in 2009 and to $2.7bn in 2011. ODA increased by 17.39% between 2009 and 2011.While, ODA to education sector of SSA was $1.8bn in 2002 and grew steadily until 2011 with slight downturns in 2010. However, it increased by 6.33% between 2009 and 2011.Then, the trend of ODA to SSA for the health and Infrastructure sector are shown on Fig. 4 below

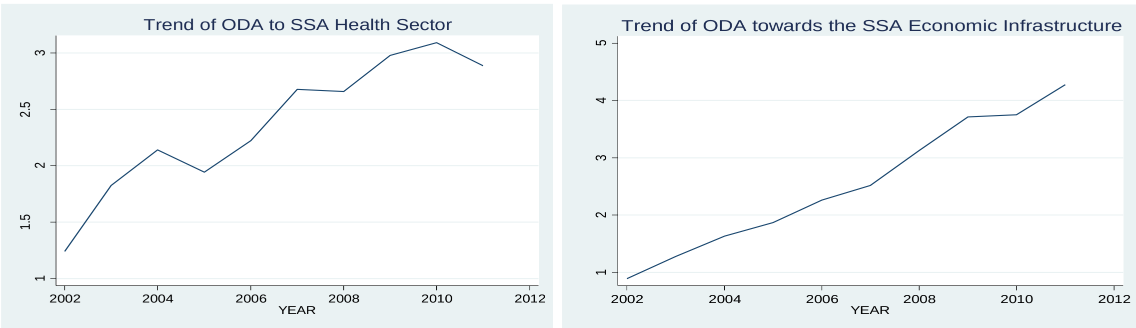


Fig. 4. ODA to SSA for Health and Economic Infrastructure

Source: Author's computation

Fig. 4 shows that the sector received an ODA of $1.2bn in 2002 androse to $2.97bn in 2009 and further to $3.1bn in 2010 but dropped slightly to $2.88bn in 2011. The health sector appears to be the only sector that witnessed a slight decline of only about 9% between 2009 and 2011. On the other hand, ODA towards economic infrastructure in SSA was $0.9bn in 2002. It grew gradually to $3.1bn in 2008 and further to $3.71bn in 2009. It rose further to $3.75bn and $4.3bn in 2010 and 2011 respectively.

Combining all the trends, Fig 5 shows that the educational sector has received the most amount of foreign aid, followed by aid on economic infrastructure, Health sector and lastly aid on the Agricultural sector.

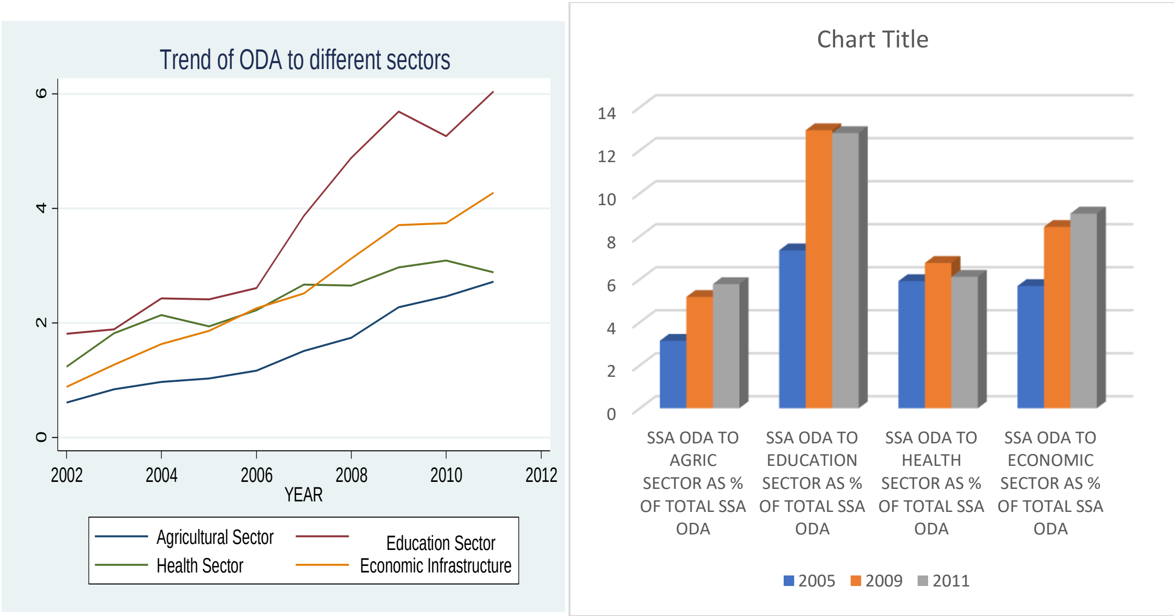


Fig. 5. ODA to SSA for Agriculture, Education, Health and Economic Infrastructural sectors

4. CONCLUSION

What has informed this study is the importance of foreign aid to Africa and its trend before, during and after the 2007-2009 Global Financial Crisis. The study employs times series data to show the trend of low income countries, lower middle, higher middle and all Sub-Saharan countries. The study equally performs structural break tests using Bai-Perron and Chow test to ascertain structural breaks during the period 1960-2014. The study equally analysed the trend of ODA on agriculture, education, health and economic infrastructure in Sub Saharan Africa between the periods 1960-2014. The results show that, though Overall ODA dropped in 2007, it consistently increased up to 2013 by 25%. The structural break test shows that the trend of ODA has not significantly changed as a result of the Global financial crisis for; low, lower middle, higher middle and Sub Saharan countries as a whole. The result further shows that ODA to low income countries were higher than those of lower middle income countries which was equally higher than higher middle income countries. ODA to the agricultural, educational and economic infrastructural sector all increased after 2009. It is only ODA to the health sector that dropped significantly. The study therefore concludes that aid Foreign aid to Africa has not declined, but rather improved in most cases. The study commends the efforts of aid donors who have been generous in the face of such a financial crisis that left many world powers in recessions. The study further joins voices to emphasize the complementing role of foreign aid to the sustenance of Africa. Finally the study appreciates the fact that ODA is progressive in nature in an effort to minimize income inequality and recommends that more of such strategies be taken to optimize the potential of ODA to Africa.

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