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A Critical Examination of Foreign Aid Policy. Why it Fails to Eradicate Poverty?

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Abstract. *After many decades of perpetuated failures, the foreign aid policy requires a critical reexamination. Doubting the efficiency of the foreign aid under the current institutional frame does not have to be interpreted as abandoning the many and the poor (approximately two thirds of the world's population, mainly in the underdeveloped countries). The goal itself is not the subject of our critique here, but the ways to address that goal, promoted up to now by developed countries and the UN.*

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Introduction

In a world struggling for more and more democratization – with or without the will of the participants – global interventionalism presents itself under new shapes and forms. Some of these forms are involving aggression, other compassion and financial assistance(1). In this paper we will only address the international solidarity policy, flatulently called external financial assistance.

In this paper we try to offer a critical analysis of the foreign aid policies that developed countries and international institutions continually promote in order to fight poverty in the Third World. By its nature, this process is redistributive since the external assistance consists of a fund transfer from the tax payers of the developed countries to the governments of the underdeveloped ones, either directly – via national authorities, or indirectly – via international organizations. Therefore, it is correct to consider the framework of foreign aid as a purely imitation at a global scale of the welfare state mechanism. Just like the welfare state-oriented countries ended in a giant implosion of the social system because of redistributive practices, we will also assist to the breakdown of the redistributive schema regardless of its wider application, be it European or worldwide. Therefore, both theoretically and practically, the foreign aid policy requires a critical reexamination. Doubting the efficiency of the foreign aid under the current institutional frame, especially after decades of perpetual failures(2), does not have to be interpreted as abandoning the many and the poor (approximately two thirds of the world's population, mainly in the underdeveloped countries). The goal itself is not the subject of our critique here, but the ways to address that goal, promoted up to now by developed countries and the UN(3).

Right from the beginning of this analysis we must highlight the main effects of this policy. Firstly, building and applying foreign aid policy resulted in creating a special kind of countries – the Third World. Without this international program of financial assistance there wouldn't have been this conglomerate of countries in need of help and that turned out – quite often – to be hostile to the West. In fact, as Peter Bauer stated long time ago, the introduction of the term "Third World" and selecting the member states is filled with flaws and ambiguities, since poverty is not necessarily a common trait. Certainly the underdeveloped countries are not and have never been homogeneous (Bauer, 1981, p. 88). These societies differ dramatically in terms of evolution, culture or income and comprise both aborigine African tribes and the population of Middle East, South East Asia and Latin America. In these later countries there are many groups of people whose standards of living are close to the ones in the developed countries. For example in 1979 some of the largest oil exporting countries such as Saudi Arabia and Kuwait were still on the list for funds receiving, even if they could be considered actually wealthy according to the welfare indicators presented in textbooks. We must understand that this clustering with all its imperfections and dubious utility is a first and very essential step to justify the emergence and development of the famous international financial institutions. It is certain that UN and other affiliated institutions were interested to promote the international assistance policies to as many countries as possible. The higher the need for external assistance, the more justifiable their activity, and thus the more urgent the collecting of international funds. If we go back in time of their founding, immediately after the WW II, these institutions have permanently extended their influence and attributions, and this process continues today.

For instance, the UN – as the main sponsor of the utopist financial assistance programs – constantly establishes new temporal deadlines to eradicate poverty: "The Eight Millennium Development Goals target, for example, to reduce extreme poverty by half, to stop the expansion of epidemics and HIV disease, and also to provide primary education universally among the people of the third world(4)". And, very important, all of these have to be accomplished until 2015!

What may seem surprising is the fact that the emergence of the latest UN agenda has a twofold role. The first one is to support the population of some countries to step out of the range of extreme poverty, and the second, to help the organization itself. The speech of the UN general Secretary Kofi Annan, at the September 2005 International Summit, asserts this when he said that the 2015 Agenda must be seen as an "opportunity to revitalize the UN itself"(5).

It is easy to understand that this mechanism (International Organizations – third world – Foreign Aid) is inherently linked, interdependent and self-sustained. What is even more obvious from this *status quo* is that there is no strong incentive for these organizations to reform the poor countries, because (obviously) a healthy pro-market reform leads to increased economic performance and, consequently, a decreased need for external financial support. As a result, the international institutions would become futile. This can easily clarify two things. On one hand, there is a lack of convergence between stated objectives, namely eradicating global poverty, and the institutions' wish of self-perpetuating. On the other hand, one can explain the consistency of perpetuating certain programs and financial tools in external assistance that both theoretically and empirically have proved themselves to be a colossal failure.

The second major consequence of the foreign aid is the excessive politization both in the West and in the poor countries. The frequency and intensity of internal conflicts in many of these countries (like Indonesia, Malaysia, Lebanon, Uganda, Somalia or Nigeria) are often the direct result of exacerbated politization of the society. It is not by accident that the struggle for political (and hence economic) power turned into prolonged civil wars. There are plenty of examples of countries where power is gained and held through the use of arms. Considering this context it is understandable why in many countries the leaders that got to power were closer to the ideology of socialist's regimes rather than the capitalist ones (Bauer, 1981, p. 89). As a consequence, leaders from undeveloped countries solicited (as they still do) financial aid from the western governments for two main and undeclared purposes: on the one hand, to satisfy their own economic and power interests and, on the other, to promote and to sustain the socialist practices. This is why today, more than 20 years after the Fall of the Berlin Wall and the cvasi-general collapse of communism, maintaining the socialists practices in many of the third world countries on the expense of the capitalist taxpayers is no doubt the ultimate defiance displayed by the (maybe too recently) proclaimed dead socialist system.

A critical examination of the conventional arguments

Once the financial assistance agencies have grown and developed they have also perfected and multiplied their arguments in order to justify the external financial support. Peter Bauer (1981, p. 97) identified the most common arguments meant to support foreign financial assistance: (a) it is instrument for economic development; (b) reduces the poverty; (c) it is a powerful tool for international income redistribution; (d) acknowledging past mistakes and making up for them with compensating measures; (e) serving the interests of developed countries; (f) helps controlling the unprecedented growth in population. It must also be mentioned that (d) became one of the arguments only after the 50s when the guilt has become a largely accepted dogma. Based on the policy "a fitting argument for everyone" foreign aid promoters astutely changed the arguments according to the audience, making impossible to examine and analyze systematically such policies and their effects. For more conservative individuals the argument was that financial aid is nothing but a tool to accomplish strategic political and military aims. When the audience is social-democrat the arguments are mainly eradicating poverty and redistributing wealth, and when faced with a business audience it was claimed that by increasing foreign aid exports and employment were being stimulated. The following will be a (constructive) criticism of these justifications:

- *Promoting economic development*

Immediately after the Second World War, the business world grows more found of the idea that the capital stock is the major growth factor for economic development(6). Underdeveloped countries seem therefore trapped in a vicious cycle by the low level of income which does not favor savings and therefore the lack of investments. As a result, they will stay poor and the only way out from this poverty trap is foreign aid. But the argument is logically inconsistent because poverty is not a *modus vivendi* and a self perpetuating state. If this were true, then there shouldn't be such a high number of individual, groups and societies that got out of this trap. Or it wouldn't be possible at all that countries such as Chile that initially was part of the third world to follow the path towards development following the extensive pro-market reforms started by Pinochet.

By his nature, man is in the pursuit of a better life (whether material or spiritual one). In a modern society he is receptive to the array of incentives and constrains present in the social context and if these are favorable to development and capital saving, the initial lack of savings is no longer a problem. Economic performance depends on cultural premises, on individual skills, on motivational structure and also on the political system. In many countries of the world where there is a strong preference for a contemplative life where social customs forbid hiring women, etc., material wealth is quite scarce. So the wealth level (in its material aspect) is the natural consequence of individual actions, based on their relative preferences. As a consequence it is not the West's fault that the prevalent preference of some African or Asian societies is contrary to accumulating material wealth. This leads to the question: Do all the underdeveloped countries want to get material prosperity such as the West? If so, are the current mechanisms and financial institutions the most appropriate way to achieve this goal?

By definition the concept of economic development is about the positive evolution of the standard of living and the quality of life on the long term. Even if it had positive effects or it facilitated a minimum standard of living on the short term, foreign aid cannot generate a substantial long-run growth of the national income. A fundamental economic principle shows that people are receptive to rules that are prevalent in society. And if these rules are not oriented towards "active fishing" but towards "passive receiving", what kind of behavior evolution can be expected in that society?

By transforming the benefitting country into an economy dependent on foreign aid, the suboptimal *status quo* is being perpetuated and economic reform is being postponed indefinitely. More than that, even those productive private activities or initiatives are not at all encouraged. The extension of government corrupt practices limits the fair practices of private business environment to the extent that the entire economy is under control. There are also behavioral changes in the social context that are counterproductive. This state is current these days in countries like Haiti, Ethiopia, Zaire, and Burundi. In conclusion, the contribution of foreign financial aid – in its present form – to the development of the third world can be nothing but insignificant, precisely because of the major adverse effects that the aid is generating.

There is one more thing to be added about this myth of poverty. If indeed all the countries of the third world would possess all the other premises that are at the base of economic development except for capital, then the influx of foreign capital should lead *ceteris paribus* to reaching this goal. As a consequence, after more than fifty years of foreign aid programs, we wouldn't have been here in this situation in need for assistance agencies and neither would we be here criticizing their policies. All of the above show that wealth represents the effect of economic initiatives and efforts and not a prerequisite of it. Just as Bauer had explained it thoroughly, the concept of vicious circle is mistakenly identifying poverty with its cause: low income is actually poverty, but not it cause!! (1981, p. 99).

- *Eradicating poverty*

This issue has always been a central theme of foreign aid policies. Peter Bauer (1972, 1981) and more recently William Easterly (2003, 2006a, 2009) are among the few economists that explained why the approaches to fight extreme poverty are simply inefficient. It is enough to follow the process by which funds flow from the western taxpayer to the poor.

First of all, the donor government has its own political, military and commercial interests. AS a consequence it will attempt to support precisely the countries that are willing to exchange "financial friendship" with imports ranging from food, war technology to consultancy and know-how. Traditionally most part of these bilateral agreements has been accompanied by these kinds of terms, even though as Easterly (2009) shows, this phenomenon has now decreased. In these cases, these accords have too few in common with eradicating poverty and stimulating economic growth in those countries.

Still, even if development is maintained as a strategic target, one can see a peculiar if not incorrect approach in allocating the funds (Shleifer, 2009, p. 382). Let's think about Sweden, where the government decided supporting socialist policies from Tanzania. Or for instance, the French government, supporting the dictators of the ex colonies of Western Africa, if they met only one essential condition: being Francophiles!

Secondly we must add that neither the financial aid given by the UN goes directly to the individual or families who are struggling for their existence. This aid also gets to the government of the country and their policies of spending money have other priorities, such as satisfying personal and group interests: from giant projects such as airports, industrial platforms of questionable efficiency, western-type universities where their graduates have no chance to find a job afterwards – to accumulating private fortunes or buying many assets – such as luxurious properties, fancy cars or bank accounts. One of the most illustrative example was that of the former president of Zaire (currently, the Republic of Congo), Mobutu Sese Seko. He was constantly concerned with his personal fortune that in 1984 was of about approximately five billion dollars. It may seem surprising for some but that was about the same amount of the external national debt at that time. Even more, in 1989, while his government was confronting with the issue of returning loans to Belgium, Mobutu had bought a fleet of Mercedes Limos that he used to walk around between his numerous palaces. And, when the money is not stolen by the leader of the country, there are always plenty of public officials or other bureaucrats that would also want a share of the funds they were supposed to manage.

Since a big part of the giant infrastructure projects stemmed from the political vision require domestic cofinancing it is easy to understand how foreign financial aid (for leaders) was implicitly an additional fiscal burden (for the most part of the population). This is why most of the times instead of ameliorating their economic situation, western aid would only deepen the crisis and increase poverty for the poor masses.

Poor people, especially in the rural area forming the majority, are not of political interest and therefore are of no concern for the political leaders in power. The real beneficiaries of the funds are from the urban areas, educated, with access to information and especially with political influence. Therefore, politicians, public officials and people from the academic or military domain are the direct or indirect beneficiaries of the western funds. In all this time, the social groups that were in real need of help are left outside the foreign aid range (Bauer, 1981, p. 111).

Thirdly, not even the stand-by agreements promoted by the World Bank and the IMF are without flaws and anomalies in allocating the resources. Although the loans are granted to governments based on some economic programs for stabilizing the economy and government budget, it is very difficult for the foreign institutions to control and direct the way the money is spent. Analyzing from a historical perspective the conditionalities associated to these accords are typically a failure! (Svensson, 2003, Easterly, 2009). However, unlike the UN grants, external loans promoted by the World Bank and IMF are actually financial aid that must be returned on short or medium term. These have even gained the name "heinous loans" since the money is stolen by the government and their interest groups and the population is forced to bear an additional tax burden in order to return the money (Shleifer, 2009, p. 383). Going back to history, there are not so many (to be more precisely, not even one!) countries that have succeed in their way through development only by external loans from international financial institutions!

- *Egalitarism and restitution*

Redistributing revenues and paying compensating sums of money go together in the egalitarist rhetoric, especially because of the idea that the differences in income levels are a direct consequence of exploitation. Thus, promoting the redistribution in order to smoothen the differences and pay some compensatory money for exploiting the Third World are the argumentative mix that justifies a significant amount of financial transfers of money, although they are logically quite distinct (Bauer, 1981, p. 121).

World egalitarism is based on the idea that people's needs are fundamentally the same, no matter what is their culture heritage or geographic area. Moreover, their abilities, skills, motivations and values are rather homogeneous which would lead us to conclude that the differences in wealth between countries and individuals are nothing but the result of exploitation or luck. If it is exploitation, it is required to seize some of the extra wealth and give it to the exploited. How much? How to do that? It doesn't matter. What matters is the ending: *for the same needs the same income*! By applying globally this way of thinking will only reduce income levels for all the countries in the world. It is obvious that the basic premise of this reasoning is completely false and an *in extenso* argument would be useless.

As about the Western blame for the precarious state of many ex colonies there is also a logical inconsistency. First, by transferring ideas and technologies from the West there has been an improvement of the standard of living and an increase in life expectancy for billions of people in the Third World. Secondly, as Peter Bauer ironically stated, all of these victims of colonialism – people killed during the wars, farmers exploited by colonists – they're all dead now and can no longer be helped, not even by prestigious institutions such as the World Bank (1981, p. 121).

Thirdly, even if we hypothetically accept the fact that colonialism has been overall a bane for the ex colonies, financial aid still wouldn't be justified.

On the one hand, this is because most of the current taxpayers have never been colonialists in the past. On the contrary, they even defended their borders from the empires seeking expansion. As a consequence they shouldn't contribute, but may be even receive compensating money. On the other hand, many of the benefiting countries (currently on the UN list) have never been colonies of the western world, because they never represented an economic or politico-strategic interest.

Although definitely the actions of colonial powers have made countless victims, any redistribution theory will fail because, with the exception of some short period of time, some mistakes of the past cannot be repaired (Bauer, 1981, p. 121). How far should we go back in our historical past to start paying for the damages? For example, if the Romanian people were included in the third world countries, should we be asking compensating payments to Russia? Or should we also address Turkey for the human and material damages done by the Ottoman Empire? What about the Huns and Tatars, should we also approach their descendants to pay us compensations?

Fourthly, as we said in the opening of this paper, it is difficult to blame the colonists for the current lack of economic performance of many Third World countries. As long as the economic situation was better than in the pre-colonial era and since this has not been any better after gaining independence it only confirms the later argument.

In 2010, more than half a century of international financial aid later, we can only admit that, although strongly criticizes during his times, Peter Bauer was right: foreign aid has failed in reaching its main goal – eradicating poverty and relaunching the economy. Today, instead of the Berlin Wall we are faced with the Foreign Aid Wall, behind which poor people should escape from poverty by means of international collectivist planning (Easterly, 2006b). Instead of allowing markets and societies to prosper by economic freedom – the successful recipe of the western economies – the poor people of the world have to accept the collectivist guidelines of international experts to get out of the poverty trap.

The African case. Some illustrative examples of foreign aid „performance"(7)

Between 1980 and 1988, Sub-Saharian African countries were beneficiaries of foreign assistance estimated at 83 billion dollars. And, as international statistics shows, in spite of economic growth and prosperity, those countries experienced an annually constant decrease in living standards by 1.2 percent. Analyzing the economic growth phenomena for a larger period of time, between 1965 and 1984, studies reveals that 18 African countries had an annual growth rate less than 1 percent, and the worst performers were Benin, Burkina, Faso, Chad, Ghana, Liberia, Somalia, Sudan, Uganda and Zaire. It might be surprinzing to find out that these countries had shared – and most of them continue to share – two common features which are worthy to mention. In the first place, the political regime is characterized by military dictatorship. Secondly, their governments have had received financial support from the West through the external assistance programs.

In the midst of 1980, even the UN had manifested some skepticism regarding the issue of eradicating poverty of the African continent. The laborious (self) evaluations of financial aid programs show off the lack of efficiency in attaining estimated specific indicators. Normally, we would expect to see at work a completely new paradigm in this matter. Nevertheless, international organizations have proved a strong bureaucracy path-dependence. Thus, then (just like nowadays) was adopted a sham change of the existing strategy. In 1986, has been launched a (new) Program of Action for African Economic Recovery and Development, with new deadlines, bigger goals, and, above all, for more money. A midterm report submitted by Secretary-General Javier Perez de Cuellar in September 1988 reveals a new failure: The general economic conditions in Africa have worsened since the program was adopted. GDP per capita of the continent declined by 2 percent in 1986 and by 2.2 percent in 1987, and is today lower than in 1980" (Perez, 1988).

The experiences that every country faces are alarming. For example, in Tanzania, the biggest part of foreign aid goes to support the socialist movement called *ujaama*. The New York Times reported: "At first, many western aid donors, particularly in Scandinavia, gave enthusiastic backing to this socialist experiment, pouring an estimated $10 billion into Tanzania over 20 years. Yet, today as Mr. Nyerere (the country's leader) leaves the stage, the country's largely agricultural economy is in ruins, with its 26 million people eking out their living on a per capita income of slightly more than $200 a year, one of the lowest in the world" (Lewis, 1990).

In the World Bank review report from 1990, it is emphasized that Tanzania's economy contracted on average by 0.5 percent per year between 1965 and 1988. The medium level of personal consumption declined drastically by 43 percent in the same period. Analyzing the results in this matter, The Economist observed in 1990 that, in exchange for huge external financial assistance, Tanzania offers pot-holed roads, decaying buildings, demoralized clinics and universities, and a 1988 income per capita of only $160 (lower than at independence in 1961!) (The Economist).

Regarding the aid programs, professor Nicholas Eberstadt, from Harvard University, offers a more trenchant indictment, emphasizing that "western aid today may be compromising economic progress in Africa and retarding its development of human capital" (Eberstadt, 1988, p. 100).

Another case might be Senegal, and certainly it is not an isolated one in Africa. For example, US built 50 crop-storage depots but placed them in locations the peassants never visited. This investment of about 2 million is in ruins now. Also, 20 percent of foreign assistance given to Ivory Coast was directed to built two sugar mills that started production in 1981 and are now closed" (Mufson, 1985).

In another African country, Sudan, was built a plant for making tomato in an area where the farmers cultivate date palms, not tomatoes. A milk dehydration plant was buit in an area where there are no diary cows. In northern Kenya, Norwegian experts built a fish-freezing plant near a lake for the Turkana tribesmen. But the Turkana are pastoral people who survive by raising cattle, goats and camels. Worse, after the plant was built, it was discovered that freezing fish in the daily 100 degree temperatures would take more electricity than was available in the entire Turkana district (Whitaker, 1988, p. 60). And there are many more others....

Notes

(1) It is also true that these aspects cannot be substituted. As recent history shows, once the recently tyrannised countries have been democratised *volens-nolens*, they benefited from major foreign aid programs in order to develop their economies. The result in these cases, as in many others, has been pathetic, compared to the expected results.

(2) This is obvious since there is still today this category called the Third World. Yet the *a-posteriori* evidence suggesting the lack of efficiens have never led to a major change in the tools and procedures used, therefore widening the gap between desired outcome and actual performance. A good example is shown by Jeffrey Sachs in his famous work *The End of Poverty* (2005, p. 25). In 2002, all the 191 countries members of the UN established eight devlopment goals to accomplish (named maybe too emphatically, Millenium Development Goals) so that by 2015 global poverty should be half of that from the year 1990.

(3) The need for shifting the paradigm in foreign aid can be felt even for the famous international financial institutions. In a World Bank study of 2005, Michael Klein and Tim Harford analyze (in chapter 9) the efficiency of the *foreign aid policy,* under an interesting title "Can the Financial Aid Agencies Perform Better Tthan the Invisible Hand?".

(4) Access the source www.un.org/milleniumgoals/.

(5) For those interested, please access the following source www.un.org/summit2005/.

(6) For those familiar with the evolution in the theory of economic growth, it is easy to correlate the extension of the philosophy of foreign aid policy with the international scientific recognition of Robert Solow after 1956, once his famous model of exogenous economic growth was published, with capital as the main factor.

(7) Most of the cases included in this last part are extracted from "Perpetuating Poverty. The World Bank, the IMF, and the Developing World", edited by Doug Bandow and Jan Vasquez.

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