

Need and the Need for Favors

Motivate Foreign Aid Decisions

By Howard J. Wall

Amounts of aid from all sources from all over the world to individual countries averaged about \$338 million and ranged from the \$46,000 received per year by Bermuda to the \$2.3 billion per year received by Iraq.

The criteria by which foreign aid is distributed have long been debated. Most of the arguments can be placed into one of two broad models of aid criteria—recipient needs and donor interests. In the recipient-needs model, “aid is given to compensate for the shortfalls in domestic resources.” In the donor-interests model, aid serves donors’ “political/security, investment and trade interests.”¹ Although the debate is often polarized into these two models, research shows that both models are valid, although aid probably has become more responsive to recipient needs since the end of the Cold War.

According to the World Bank, total worldwide foreign aid averaged just short of \$77 billion per year during 2002-04, and there were 172 countries that were net recipients of aid over the period.² Amounts of aid from all sources from all over the world to individual countries averaged about \$338 million and ranged from the \$46,000 received per year by Bermuda to the \$2.3 billion per year received by Iraq.

From the table, which lists the top and bottom 15 aid recipients between 2002 and 2004, one can easily see elements of both models.

The role of recipient needs is apparent from the relative poverty of the top 15 recipients and the relative affluence of the bottom 15. Donor interests are most obvious from the very large allocations to Iraq and Afghanistan. Although they are relatively poor countries (they are classified by the World Bank as lower-middle and low income countries, respectively), their rankings at the top of the table are in large part due to donors’ political and strategic objectives intertwined with the countries’ needs. Similarly, the aid totals for Egypt and the West Bank and Gaza have much to do with considerations other than economic need.

Other patterns and oddities are apparent in the list of the bottom 15 countries. These countries tend to be very small. But most of them are high-income countries that nevertheless are net recipients of aid. Four exceptions are St. Vincent and the Grenadines, Seychelles, St. Kitts and Nevis, and Libya, but even they are classified as upper-middle income.

Recipient Needs during the Cold War

As illustrated by the table, there are elements of recipient needs and donor interests in the allocation of foreign aid. Because of this, it is important to disentangle the two

sets of motivations when trying to understand how responsive aid is to the needs of the recipient countries. It is difficult, however, to come up with very good measures of political and strategic interests. An early study by William Trumbull and Howard Wall gets around this by using a “fixed-effects” approach, which simply allows for each recipient country to have its own strategic and political relationship with donors, without the need to find actual data to capture the relationship. Although this approach does not provide estimates of the role of donor interests, it does provide better estimates of the role of recipient needs than do approaches that ignore donor interests altogether.

Using data for 1984-89, Trumbull and Wall measured recipient needs by per capita income and infant mortality.³ Although countries with low per capita incomes tend to also have high infant mortality, these variables nevertheless measure two different classes of need: Per capita income measures economic need, while infant mortality measures physical need. These two measures do not necessarily move together in the short run; so, it is possible that aid responds differently to changes in the two types of need. Trumbull and Wall found that levels of foreign aid responded to changes in infant mortality (physical need), but not to changes in per capita income (economic need). They also found that improved civil and political rights tended to mean increases in aid.⁴

Recipient Needs vs. Strategic Interests

More recently, Alberto Alesina and David Dollar, who were interested in the relative importance of strategic interests and recipient needs, took a different approach. To achieve their purposes, it was necessary to include actual variables to measure the strategic interests of donor countries and to consider them alongside the measures of recipient need. When they looked at aid allocations over the period 1970-94, they found that “the direction of foreign aid is dictated as much by political and strategic considerations as by the economic needs and policy performance of the recipients.”⁵ According to their results, aid responded to per capita income and political rights, but only marginally to infant mortality. In contrast, aid was highly responsive to whether a recipient had a colonial past

Foreign Aid Recipients

ANNUAL AVERAGE 2002-2004			
Top 15	\$ million	Bottom 15	\$ million
Iraq	2,335	Bermuda	0.05
Afghanistan	1,687	Qatar	2.1
Vietnam	1,627	Kuwait	3.9
Ethiopia	1,566	Bahamas, The	4.7
Pakistan	1,538	United Arab Emirates	4.7
China	1,496	Macao, China	4.9
Mozambique	1,491	Hong Kong, China	5.3
Serbia	1,472	Antigua and Barbuda	7.0
Russian Federation	1,290	St. Vincent and the Grenadines	7.0
Bangladesh	1,238	Singapore	7.8
West Bank and Gaza	1,235	Malta	8.8
Egypt, Arab Rep.	1,226	St. Lucia	8.9
Poland	1,199	Libya	9.0
Indonesia	1,068	Seychelles	9.1
India	1,011	St. Kitts and Nevis	9.4

SOURCE: World Bank

and whether its votes in the United Nations tended to follow those of major donors.⁶

This analysis provided a very different picture of the responsiveness of aid to recipient needs. It wasn’t just that Alesina and Dollar found that, in contrast with Trumbull and Wall, aid responded to economic rather than physical need, but that for the very poorest countries aid actually decreased if they became poorer. There are good reasons, however, to doubt these results. Although the strength of Alesina and Dollar’s approach is that it is possible for them to compare the two views of aid allocation simultaneously, its weakness is that there is a good chance that the role of recipient needs is misestimated. This is likely to happen unless the measures of strategic interests that they include are comprehensive. Further, because the period they analyzed spanned the end of the Cold War, the chances of this misestimation are greatly amplified.

After the Cold War

Recently, two St. Louis Fed economists, Subhayu Bandyopadhyay and Howard Wall, tried to get around these problems. They used the fixed-effects approach and confined their analysis to a portion of the post-Cold War period so that they did not have to

ENDNOTES

- ¹ See Maizels and Nissanke (1984).
- ² Here, “foreign aid” means net official development assistance and net official aid. Net official development assistance consists of disbursements of loans made on concessional terms and grants by countries and multilateral institutions to promote economic development. Net official aid refers to aid flows (net of repayments) from official donors.
- ³ Infant mortality is the number of deaths of infants 1 year old or younger per 1,000 live births.
- ⁴ When fixed effects estimation was not used, income per capita was important while infant mortality was not, and civil/political rights was less than one-third as important.
- ⁵ See Alesina and Dollar (2000).
- ⁶ Specifically, they found that more aid tended to go to countries whose U.N. votes were similar to Japan’s, but that the same was not true for countries whose votes followed the United States’.

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actually measure donors' strategic interests to obtain good estimates of the importance of recipient needs.

What Bandyopadhyay and Wall found was that aid responded strongly and in the expected ways to economic and physical needs. Specifically, if the average recipient country saw its per capita income rise by 10 percent, it would tend to see a 10 percent decrease in the aid it receives. Also, if the average country saw its infant mortality worsen (i.e., its infant mortality rate increased) by 10 percent, its aid would rise by about 3 percent.

Aid also was found to respond strongly to changes in the behavior of the governments of recipient countries: If a country with the average level of civil and political rights changed its policies and became one of the freest countries, its aid would rise by about 17 percent. Finally, if a government with an average effectiveness in using funds efficiently became moderately more effective (i.e., improved by one standard deviation), its aid would rise by about 25 percent.

Lessons

There should be little doubt that foreign aid is related to the strategic interests of donor countries. Although the nature of this relationship is not known with much precision, the information in the table alone should convince anyone of the existence and importance of the relationship. There should also be little doubt that aid is responsive to changes in the needs, both economic and physical, of recipient countries. Therefore, the donor-interest and recipient-needs models are both relevant to the allocation of foreign aid.

Finally, and perhaps surprising to many, aid is strongly responsive to changes in the level of civil and political rights in recipient countries, as well as to the improvements in the effectiveness of recipient governments in using aid that they are given. It also appears that the link between aid and the needs of recipient countries is stronger than it was during the Cold War. ¹⁰

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