OF MUSLIM COUNTRIES - A STUDY OF SELECTED COUNTRIES

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This is to certify that Bro./~~Sis~~ ABU BAKR ABDULLAH SOKOTO has written the Master of Economics research paper entitled: THE ROLE OF FOREIGN AID IN ECONOMIC DEVELOPMENT OF MUSLIM COUNTRIES

under my supervision. The relevant comments made on the paper during its presentation have been incorporated in the present version of the paper to my full satisfaction.

I have pleasure in recommending that the graduate committee may approve the paper in partial fulfilment of the requirements for the degree of Master of Economics.

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A STUDY OF SELECTED COUNTRIES

A. INTRODUCTION

The idea of financing economic development relates to the provision of real resources to raise the level of real output in a developing economy. The major source of resource for any country's capital formation is its domestic savings. In an economy where Investment demand cannot be met entirely by domestically generated saving including net foreign exchange earnings through trade surplus, a transfer of resource in the form of grants, loans remittances or direct investment from Foreign Countries offers the widely used option. This paper attempts to make a discussion on issues related to the role of foreign aid as a form of resource transfer from the economically developed countries to the capital deficient Muslim Countries[1] and its implication in the shortrun and long run on their economies.

The idea that rich countries should assist the poor countries in their development efforts was reinforced after the second World War. The nature of this aid relationship is highly contentious and a vast amount of literature is produced on every aspect of the subject. Important and diverse questions pertaining to what is aid?, how much aid should the rich countries be providing?, how effective it has been, who should

1 Muslim Countries here, refer to the selected Muslim nations that are members of the Organisation of the Islamic Conference (OIC), or countries where muslims constitute the larger percentage of the population.

be responsible for its disbursement, and on what criteria? have all been given different answers.

We would like to make it clear that an exhaustive discussion on the economic contribution and implications made by the international flow of development financing from the Development Assistance Committee (DAC)[2] of OECD to all the Muslim countries, is beyond the scope of this paper: Nonetheless some illustrative indicators are examined to draw relevant conclusions on aid policies among DAC donors.

The objective of the paper is to look at Foreign aid from the point of view of its effectiveness in enhancing economic development in selected Muslim countries. Those countries are Algeria, Bangladesh, Egypt, Jordan, Mali, Nigeria, Pakistan, Senegal, Sierra leone, Somalia, Tanzania and Tunisia. Thus the paper will discuss the various economic and social consequenses that are associated with the aid to the Muslim Countries.

The Muslim countries being part of the developing countries (LDCS, Third world) are greatly affected by the aid policies outlined and carried out by the DAC donor - countries that have little or no religious and socio-cultural similarities

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[2] The Development Assistance Committee of the Organisation of Economic Co-operation and Development (OECD) consist of the following members; Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, The Netherlands, New Zealand, Norway, Sweden, Switzerland, United Kingdom, United States of America and the Commission of European Economic Community.

with most of the Muslim countries. Some portion of the development assistance is coming from the organization of Petroleum Exporting Countries (OPEC)[3] and CMEA[4]. However, since Foreign Aid coming from these sources is quite small this paper will concentrate on the aid given by the DAC donors, with at most a passing reference to these two other sources of financing.

It is pertinent to bear in mind that an area like foreign aid (though seems to be an innocent area) is not a subject which can be studied and analysed in isolation, it must always be examined within the realistic context of the prevalent international political and economic affairs. On this line, the recent collapse of the Soviet Union and the emergence of the Commonwealth of Independent States in its place, cast a big doubt about the likely pattern of future aid policies of some influential DAC donors, notably the United States, Britain, France and Japan.

The paper is divided into five sections. Section A is the Introduction. Section B elaborates on the meaning, role, and

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3 OPEC : Organization of Petroleum Exporting Countries whose ten donors are : Algeria, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, The United Arab Emirate and Venuezuela. The remaining three OPEC members are not included since they are not sources of ODA flow to other nations.

4 CMEA :- Council for Mutual Economic Assistantance, whose European members consists of : Bulgaria, Cheschoslavakia, former East Germany, Hungary, Poland and the former Union of Soviet Socialist Republics.

Objectives of Foreign Aid. Section C discusses Foreign Aid and Growth Models. Section D elaborates on Aid flows and their impacts on Muslim Countries as recipients of the said aid. Section (E) is the conclusion and remedial suggestions.

B. MEANING, ROLE AND OBJECTIVES OF FOREIGN AID.

In this paper, we have tried to be precise on what we have referred to as 'aid'. This means that 'aid' is not everything which results in transfer of resources and which is often commonly referred to as aid. For instance all private Foreign Investment export credit and public loans at commercial rates of interest do not represent aid in this paper, even though, they may be useful to the recipient since there is a quid pro quo. Thus for the purpose of this study, the term 'aid' refers strictly to flows which qualify as official development Assistance (ODA) according to DAC definition. That is grants and loans that are undertaken by the Official sector with (a) promotion of economic development and welfare as the main objective and (b) having concessional[5] financial terms.

It was only after the second World War that the concept of Foreign Aid is found in official documents. Prior to this

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5 Loans at concessional terms, are loans with interest rates below the market rates, perhaps, with an initial period in which no interest is charged or loans payable in the local currency.

period, there were terms like 'budgetary subsidy or grants in aid' that reflects the practice of the colonial masters when they transfer capital on concessionary terms to their respective colonies. The 1950s witnessed the beginning of aid as is understood in the present day, reflecting transaction between sovereign states.

To many developing countries, the official development assistance from DAC serve as a useful flow in financing various development projects, particularlyimportant perhaps is the role of grants, (which unlike loans, impose no burden of amortization and the payment of interest).

The role of foreign aid in the economic development process of the recipients is classified into three by P. Donaldson (1986) as follows:

1. As an external supplement to inadequate domestic capital formation.
2. As a means of overcoming foreign exchange constraints on economic development.
3. As an agent for international diffusing of economic and technical knowledge.[6]

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[6] Donaldson, P., Worlds Apart, Penguin Books London, 1986, p. 138.

According to the first role, by raising the level of income with a given absorptive capacity and marginal propensity to save, foreign aid raises the level of domestic savings as well as the capacity to export. Because of the realization of the unavoidable fact of the complex interdependence in the contemporary world, there is a consensus of opinion among some enlightened personalities for the need to analyse the 'mutual interest' of the rich countries and the less developed countries in achieving a desired level of development beneficial to all the groups.

As we had mentioned earlier in this paper, immediately after the second world war, foreign aid came into being as a factor of socio-economic transformation and reconstruction of the devastated economies of Europe and Japan. A programme which follow shortly is the launching of development efforts in Africa, Asia and latin America. Several bilateral and multilateral[7] international institutions were established to provide external financial resources and the necessary technical assistance to the countries in need of these facilities.

The objective of aid allocation is the reduction of the ever-widening international disparity between the developed and the less developed countries. In as much as the aid programme

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[7] Multilateral aid, is aid chanelled through a multilateral organisation whose policies are governed by the collective decisions of net contributors and recipients.

is geared to this end, the rule that all contributions of the rich countries to help the developing countries achieve the appropriate level of development have to take into account the ultimate development needs of these countries. This is more so on the part of the Muslim countries, who have a development objective that is, in all intents and purposes, more comprehensive than any system can offer.

Ironically, four out of the five countries that became the principal objects of super power competition in aid programme towards the end of the 1950s were Egypt, Iran, Afghanistan and Indonesia, and are all Muslim countries.

While the various aid proposals were drawn to rid the aid programme of any other than that which is in conformity with the developmental needs of the recipients, the reality of the situation is far from that. This is because, in most cases it was the geopolitical interest of the donors that greatly determined the amount and the recipients of any development assistance from the DAC donors.

C. FOREIGN AID AND GROWTH MODELS

Theoretical and Historical Perspective

According to P. Donaldson (1986 p 128-129), after the second World War, there were four major factors that influence the advanced economies towards embarking on Foreign Aid Programme:

(i) It was the period in which many countries gained political independence. These countries faced a lot of economic problems at the initial stage of their independence. This made their former imperial masters and certain countries having no such colonial background to feel morally obliged to help solve their economic problems.

(ii) The idea of using aid as a weapon in winning the cold war.

(iii) The advancement of economic discipline which led to the emergence of growth economics which was used in solving the problems of developing countries.

(iv) The end of the second World War left Germany in a situation reminiscent to the chronic economic problems similar to what now face the less developed countries. This necessitates the Marshal plan (or aid) in which the injections of American capital helped economic prosperity in Germany.

Prior to the 1960s, it was believed among the development economists that the main purpose of capital inflow to any developing economy was to help augment the country's total investible resources. It was only during the 60s, through the pioneering work of Hollis Chenery and his associates, that the role of foreign aid in the economy was extended. According to Hagen (1975), Chenery advanced this role of aid by showing that there were two-gaps[8] which help the country from using its full capital formation potential.

During the late 1950s, and early 1960s, a large number of African and Asian countries achieved independence. This led to the rapid expansion of aid programmes of Britain and France. The early parts of 1960s saw the 'joining of the aid programme by Japan West Germany, Holland, and Scandinavian countries for the first time despite the fact that none of them had any colonial experience.

Toward the later part of the 1950s the former Soviet Union happened to be one of the donor countries giving aid to the less developed countries[9], through a formal declaration by its leader Kruschev in 1956: "These countries, although they do not belong to Socialist world system, can draw its achievements in building an independent national economy and in raising living standards of their people. Today they need not go begging from their former oppressors. For modern equipments, they can get it

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8 The Two-gap Model is a traditional approach to the analysis of the role foreign aid in economic development, where foreign aid is assumed to fill a savings - investment gap as well as a foreign exchange gap in the recipient country.

9 Prior to the death of Stalin in 1953, the only financial connection between the Soviet Union and the less developed countries had been its supports for local communist parties in these countries.

in the socialist countries free from any political or military obligation"[10]

There was a rapid expansion of aid among donors in the 1960s. This may be attributed to the fact that the 1960s was a decade in which a target was announced by the United Nations for the annual growth rate of GNP in the less developed countries, which was put at five percent and the ratio of aid to the donors' GNP put at 0.7 percent. This was also the time the DAC was established to coordinate the policies of development assistance of developed Western countries. A general realisation of the seriousness of the problems inherent in the international economic system emerged as a result of a report of the Commission of International Development headed by Lester B. Pearson (1969)[11]. The commission was set up to study how the poor and rich countries had managed to cooperate in order to promote development in the LDC's since the second World War. Some of the findings of the commission were - that aid constituted about 10 percent of total investment and finance and it constituted about 20 percent of the exports of developing countries. The Pearson commission (1969) recommended that :

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10 The former Soviet Leader Nikita Kruschev, speaking to the twentieth party congress of the communist party of the Soviet Union in 1956. Cited in Walters, R.S., American and Soviet Aid: A Comparative Analysis. University of Pitsburg Press, 1982, p. 114

11 Pearson, L.B., Partners in Development, Report of the Commission on International Development, New York: Praeger, 1969.

(a) Aid allocation must be determined by the objective which will enable the poor nations to attain a six percent growth rate of their GNP so as to be on a sound economic footing.

(b) The future aid components must be based upon the country's ability in the effective utilization of aid fund.

(c) The official aid must be raised to 0.7 per cent of GNP of donors. While the total aid flows and private investment should equal one percent of the GNP of the developed nations.

(d) There should be restructuring of aid administration procedures with the total elimination of tied aid.[12]

(e) Multilateral aid must be raised to 20 percent of total official development assistance by 1975.

There is also the Columbia Conference on International development in 1970. The conference called for more comprehensive aid policies that will solve the economic problems of most developing nations. According to the conference finding,

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[12] Tied aid is aid where the recipient, as a condition of the aid, is obliged to use the aid fund to buy goods from the donor country only. This is normally associated with bilateral aid.

it is unrealistic to assume that the relative bargaining strength of poor nations vis-a-vis the rich would have improved by the year 2000 as envisaged in the Pearson Commission.

In 1976, the OECD tried to regulate the level of aid to the developing countries by setting up 'Guiding Principles' under which the members of its Development assistance Committee - "Undertook to confine associated financing to priority projects and programmes which are carefully appraised against the developmental standards and Criteria applicable to official development assistance programmes. They also undertook not to extend associated financing transactions with a grant element of less than 20 per cent".[13]

There are resolutions in the UNCTAD[14] discussing the International Consensus on 'Massive Transfer' which has to do with money and finance in 1980. There was a recognition under the UNCTAD consensus, that massive transfer was an indispensable factor in promoting the economic development of Third World Countries which at the same time could stimulate global economic activity. The second was the explication of the important criteria upon which any procedure on massive transfer has to follow. these include the emphasis on those developing countries that depend primarily on consessional funds for external

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13 OECD, Twenty-five years of Development co-operation, Paris, 1985 .p 243.

14 UNCTAD : United Nations Conference on Trade and Development.

financing. And that any procedure on external financial assistance ought to be compatible with the development priorities of developing nations. The possibility of interest subsidy mechanism was also stressed. These measures greatly portray the aspiration of developing countries as clearly put forward in the Arusha declaration.

"The Mechanism of massive transfer would analytically imply the raising under the collective guarantee in International capital markets and their disbursement to developing countries over a long term period with an interest subsidy element as appropriate in the form of both project and programme lending structural change[15].

Despite the fact that it is always assumed that the task of resource mobilisation for achieving a desired level of economic development is the responsibility of the developing nations themselves, nonetheless, due to the unfavourable external economic conditions which they faced, they must be in need of external financial resource to supplement local efforts. Based on historical evidence, it was stated that of all the world's countries, only the Netherlands and Japan began their modern economic growth without getting external capital, Hagen (1975, p. 426). The Netherlands economic advancement was said to had been financed from the income the country got as a leading nation

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[15] UNCTAD, Arusha Programme for collective self-reliance and framework for negotiations, Manilla 1979, p. 50.

in sea-faring; while in the case of Japan, it is said that it neither received nor permitted any capital inflow until after 1900.[16] So it was only after 1900 that Japan started receiving external assistance from private concerns which was made possible due to her success in industrialization which automatically made the country an attractive candidate for foreign capital.

Apart from small amounts of investments in England by some wealthy Netherlanders, Hagen (1975) argues that it is safe to conclude that at the initial stage of England's economic development it was also almost entirely self financed. This, according to him was not, the case with France and Germany who got a substantial part of their development finance through borrowing abroad during the early stages of their industrialization processes.

It was the realization by the international community of the need for external financial assistance to the growing economy as was the case with certain European nations that reinforced the present aid relationship between the rich and the poor countries. The formal beginning of the present aid relationship was in the early 1950s, a period described by Paul (1987) as "the years in which physical capital was seen as the key limiting factor in economic development, and incremental capital-output ratio as a fairly dependent link between capital

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16 See Hagen, E. Everett., The Economics of Development, Greenwood Press, London. 1984, p. 426.

investment and growth."[17] This is also the period in which the World Bank[18] switched its attention from reconstruction to economic Development.

The resource transfer to the less developed countries in the form of foreign aid is considered to have some effects on the level of economic activity of the recipient's country. This is because it provides the country with the necessary foreign exchange required to purchase goods and services. Aid also acts as a supplement to domestic savings. But the fact that aid is not a gift perse it comes in most cases in the form of low interest loan, the blanket conditions that normally accompanied aid coupled with the problem of tying the aid to its source greatly affects the effectiveness of foreign aid in acting as s source of development financing in the recipient countries. Although most of ODA takes the form of grants, it is the loan element of it that cause a lot of problem to the recipients in the form of debt servicing. It is mentioned that "the ODA loans have an average interest rate of under 3%, and an average maturity of almost 30 years, servicing them is not costly but it

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17 Paul, M., Overseas Aid: its Defence and Reform. Wheatsheaf Books, London 1987, p. 23

18 Set up in 1955 as the International Bank for reconstruction and development. The World bank group now comprises three agencies: The International bank for Reconstruction and Development (1944), The International Finance Corporation (1956) and the International Development Association (1959).

can exacerbate a country's existing debt problems".[19] In fact, it was on this basis that the proponents of the two-gap approach came under heavy bombardments from many quarters, because it doesn't seem to take into account the debt problem, the Unnecessary conditions attached to aid and the tying of aid to the source.

D. THE ECONOMIC IMPLICATION OF FOREIGN AID ON THE SELECTED MUSLIM COUNTRIES

In this section, I selected twelve countries among the Muslim nations to be our sample in this paper. These countries are : Algeria, Bangladesh, Egypt, Jordan, Mali, Nigeria, Pakistan, Senegal, Sierra-Leone, Somalia, Tanzania and Tunisia. According to the 1991 World Development Report, five of these countries are classified as middle income nations, they are Algeria, Egypt, Jordan, Senegal and Tunisia, while the rest are all in the low income group. The rationale for selection is that eight of these countries are among the twenty five major recipients of foreign aid in the period 1973-1983 according to the report. Algeria and Nigeria, although members of OPEC, are included in the sample due to the serious economic problems affecting their economies as a result of huge external debts and the resultant conditionalities imposed by the western creditors

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[19] The OECD Observer 162, OECD Publication Service, Paris, February/March 1990, p 11

and the large portion of their GNP that is being used to service debts. The remaining two countries; Mali and Sierra leone are selected in the sample due to the fact that the official development assistance to these nations in recent times constitute a significant percentage of their GNP. Appendix III presents a ranking of 25 major recipients of foreign aid between 1973-1983.

The major source of resources for a nation's capital formation is obviously its domestic savings but at times,the domestic saving may not be sufficient toward this end. In this case, the saving capacity of the country may be supplemented by capital inflow consisting of loan or grant from abroad to the government or from the citizens or direct investment by foreign firms in the country. Table one shows the structure of aggregate demand in the selected Muslim countries and classifies demand components relative to the size of the nations' Gross Domestic Product.

Table One

Structure of Demand. Distribution of GDP (per cent)

	General Government Consumption		Private Consumption		Gross domestic Investment		Gross domestic savings		Resource Balance	
	1965	1989	1965	1969	1965	1989	1965	1989	1965	1989
Algeria	15	16	66	53	22	31	9	31	-3	0
Bangladesh	9	8	83	91	11	12	8	1	-4	-11
Egypt	19	13	67	80	18	24	14	7	-4	-17
Jordan	..	24	..	78	..	18	..	-2	..	-20
Mali	10	10	84	79	18	27	5	11	13	-15
Nigeria	5	9	83	70	14	13	12	21	-2	8
Pakistan	11	17	76	72	21	18	13	11	-8	-6
Senegal	17	16	75	73	12	15	8	11	-4	-5
Sierra Leone	8	10	83	85	12	11	8	5	-3	-6
Somalia	8	23	84	91	11	21	8	-14	-3	-35
Tanzania	10	12	74	93	15	21	16	-5	1	-26
Tunisia	15	17	64	28	274	23	14	19	-3	-4

Source: World Bank, World Development Report 1991, Oxford University Press

We can also see from the information in table one above that due to low rate of saving, low income level and the resultant negative resource balance in all with the exception of Nigeria of the countries in the 1989 period, the need for capital inflow to supplement the domestic savings is acute for these countries. The inadequacy of domestic resource is also apparent in the information given in table 2 below which shows the amount of central government deficits/surplus of the selected countries as a percentage of their Gross national product.

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