Impact of foreign aid on poverty and economic development in nigeria

Politics, International Relations

CHAPTER ONE INTRODUCTION This project focuses on thepovertyprofile in Nigeria, the foreign aids given to the nation to help alleviate poverty and how it affects the economic development of Nigeria. According to the World Bank website, “ poverty is hunger. It is lack of shelter. Poverty is being sick and not being able to see adoctor. It is not being able to go to school, not knowing how to read, and not being able to speak properly. Poverty is not having a job, and is fear for the future, and living one day at a time. It is losing a child to illness brought about by unclean water.

And lastly, it is powerlessness, lack of representation and freedom. ” Poverty is the inability to achieve a certain minimum standard of living. It is multidimensional, involving not only a lack of income, but also ill-health, illiteracy, lack of access to basic social services, and little opportunity to participate in processes that influence people’s lives. Mollie Orshansky, who developed the poverty measurements used by U. S government states that poverty is “ to be poor is to be deprived of goods and services, and other pleasures that people around us take for granted” (Schwartz, 2005) Poverty is pervasive; as about 1. billion people in the world still live on less than a dollar a day and nearly 850 million people go hungry every night. (World Bank) According to Jhighan (2003), poverty is a misery-go-round plaguing the less developed countries. 1. 1BACKGROUND TO THE STUDY The poverty level in Nigeria; as described by the World Bank (1996) is a paradox that contradicts the immense wealth it has. Nigeria is a country endowed with human, agricultural, petroleum, gas and large untapped mineral resources. It earned over US$300 billion from just petroleum during the last three decades of the twentieth century.

Rather than recoding remarkable progress in national, socio-economic development, Nigeria has retrogressed to being one of the 25 poorest countries of the 21st century while she was among the richest 50 in the early 70s. Nigeria enjoyed steady economic growth and relative stability in the 1960s and 70s especially with emergence of the mining industries. The per-capita income grew steadily and few people were between the poverty line as the agricultural public and industrial sectors absorbed a highest percentage of the labor force.

In the early 1980s, severe economic crisis shook Nigeria bringing along with them real and perceived increases in the level of poverty in the country. This was due to factors such as declining prices of oil, the country’s main export, rises in the real international interest rates that compounded the external debt and subsequent slowing down of economic activities and growth. The major underlying cause of all these was domestic policy mistakes. (Aigbokhan, 2000) In 1980, poverty was regarded as a rural phenomenon but by 1985, it had spread to urban areas.

This was due to the highrural urban migrationthat accompanied the impetus to development generated by oil revenues. Also, the collapse of oil exports income and massive importation offoodto meet the production capacity in the agricultural sector severely affected urban dwellers. Economic reforms were introduced by the government in 1986; Structural Adjustment Programme (SAP), which led to the removal of reduction of subsidies that were incidentally strategic to improving human welfare. Government spending on social services became dismal while the quality and quantity of public social services declined, especially in poor communities.

Its social costs are reflected in increasing unemployment, cuts in social services, and general increases in the prices of basic commodities. The economic reform programme placed untold hardship on the vulnerable groups of the society such as the women, children and the aged, who make up a larger share of the poor. The standard of living of the general populace fell and led to poor access to food, shelter, education, health and other essentials of life. In 1992, urban poverty remained the same at 37. 5% while rural poverty reduced to 46%.

By 1996, it was very obvious that urban poverty had become an increasing problem in Nigeria. For example, the number of people in poverty increased from 27% in 1980 to 46% in 1985. it declined slightly to 42% in 1992, and increased very sharply to 67% in 1996. In 1999, estimates showed that over 70% of Nigerians lived in poverty. The government then declared in November 1999 that the 470 billion naira budget for the year 2000 was “ to relieve poverty. ” By 1996, Nigeria had become the 13th poorest country in the world and occupied the 142nd rank on the human development index (HDI) scale. World Bank, 1996) With the reforms, the real growth became positive but there was still a question whether the reform alleviated poverty; how far poverty was reduced. Foreign aid is the economic help provided to communities of countries due to the occurrence of a humanitarian crisis or for the achievement of a socioeconomic objective. There are two types of aids: Humanitarian aid is the immediate assistance given to individuals, organizations or government for emergency relief caused by war or natural disasters.

Development aid is help given by developed countries to support economic or social development in developing countries so as to create long term sustainable economic growth. The sources of foreign aids include bilateral and multilateral aids. Bilateral aid is given by the government of one country directly to another. Multilateral aid is aid from an international financial institution; such as the World Bank; the International Monetary Fund; the African, Asian and Inter-American Development Banks; the European Development Fund; and various United Nations agencies such as the United Nations Development Programme.

These organizations are governed by individual contributing countries and capital markets. Non-governmental Organizations (NGOs) also play a major role in distributing aids. Tied aid is the aid which the donor requires a recipient to spend some or all of its foreign aid on goods and services produced in the donor’s country. This process is called tying of aids. This can also be done by offering aid as subsidized credit for the purchase of its exports.

Majority of the NGOs in Nigeria receive foreign aids from USAID (The United States Agency forInternational Development) USAID is an independent federal agency that receives overall foreign policy guidelines from the United States Secretary of State. It seeks to extend a helping hand to countries struggling for a better life, recovering from a disaster or striving to live. It supports economic growth, agriculture, trade, health, democracy, conflict prevention and humanitarian assistance. Other organizations in Nigeria also receive funds from USAID to undertake projects ranging from

HIV/AIDS prevention to bringing solar energy to a rural village. On the other hand, Nigeria is currently not eligible to receive grants through the Millennium Challenge Corporation (MCC), which was established under President Bush as part of the " new agreement for global development. " Its mission is to reduce global poverty through promotion of sustainable economic growth. Before a country is eligible to receive assistance, MCC looks at their performance on 16 independent and transparent policy indicators. Nigeria is a country, strategically important to the U. S. and a country whose citizens are greatly in need. At the same time, it is a country whose government does not pass the test for receiving aid through the MCC. 1. 2STATEMENT OF PROBLEM Poverty is a persistent problem which has existed for a long time in Nigeria. A lot of policies have been applied to alleviate it but without much success. This research x-rays the contribution of foreign aids as a solution to this problem. The specific problems we will look at in this study are the causes of poverty and also how foreign aids can contribute to poverty reduction in the Nigerian economy. . 3OBJECTIVES OF THE STUDY The major objective of this study is to examine the effects of poverty and foreign aids given to us on the development of the economy. The study will focus on other micro objectives, which include: i. To analyze the poverty profile and discuss the national trends of poverty in Nigeria. ii. To review the causes, measures and impact of poverty on the GDP of Nigeria. iii.

To identify the forms and roles of the foreign aids given to Nigeria. iv. To identify the relationship between foreign aids and poverty in the Nigerian economy. 4.

THEORETICAL FRAMEWORK This study uses the theoretical framework employed by Ogbuaku, Adebisi and Feridun (2006) based on the neoclassical growth model by Barro (1991). It is based on a small open economy version of the Solow (1956)-Swan (1956) growth model. The decision to study foreign aid in an open economy, as opposed to a closed, is three fold. First, most of the economies that receive foreign aid must reasonably be considered small and open. Second, to the extent that international credit markets are imperfect, some forms of foreign aid can have a positive impact on the poor.

Third, in our empirical work we provide statistical evidence to suggest that greater international openness and access to credit stimulates economic growth. 5. METHODOLOGY The data for this study will be mainly from secondary sources such as World Bank reports, Central Bank of Nigeria publications such as the CBN Economic and Financial Review Bullions, occasional papers, CBN annual reports and statement of accounts, Federal Office of Statistics (Statistical bulletin) and other relevant journals.

This research makes use of econometrics in estimating the relationship between poverty, foreign aids and its contribution to the development of the Nigerian economy. The multiple regression technique is used in obtaining numerical estimates of the variables in different equations. This is because the computational procedure is a component of other estimation techniques. The estimation period will be from 1981 to 2007. 6. MODEL SPECIFICATION This study uses the theoretical framework employed by Ogbuaku, Adebisi and Feridun (2006) based on the neoclassical growth model by Barro (1991).

They specify a simple model of poverty andglobalizationas follows: POV = ? 0+1 ? TRADE+ ? 2FDI+ µ (1) This model is augmented to include the foreign aid element thus: POV = ? 0+ ? 1TRADE+ ? 2FDI + ? 3AID+ µ (2) Where POV is the yearly average per capita income trade is import + export /gdp fdi is foreign direct investment aid is foreign aid µ is the stochastic error term 7. RESEARCH QUESTIONS This research aims to answer the following questions: • Has foreign aids flow reduced poverty? • Does foreign aid achieve its basic objectives in its recipient countries? Does foreign aid lead to a positive, negative or no effect on growth and economic development? 8. HYPOTHESIS To carry out this study, the following hypothesis will be tested based on a model to be specified and formulated to determine the relationship between foreign aids and economic development. Hypothesis 1 H0: Foreign aids have no significant impact on the economic development of Nigeria. H1: Foreign aids have a significant impact on the economic development of Nigeria. 1. 9SIGNIFICANCE OF THE STUDY

This significance of this project can be viewed from the perspective of using foreign aids to alleviate poverty and also develop our economy. It studies the poverty profile of the nation and shows how the proper allocation of foreign aids will help improve the development of our economy. 1. 10SCOPE/ LIMITATION OF THE STUDY The research work attempts to cover the effect of the foreign aids given on the Nigerian economy and its impact on the poverty level in our nation. It focuses on the empirical analysis of the relationship between poverty, foreign aids and inflation in Nigeria.

The objectives of this study cannot be achieved without encountering either minor or major problems. The major limitations of the study are those that characterize the use of secondary data. They include errors of improper data collections, errors of omission, the problem of over or under estimation of estimates, etc. 11. CHAPTERIZATION Chapter one contains the introductory part; the background to the study, the statement of the problem, the objective of the study and the methodology used. Chapter two contains the literature review and theoretical framework. Chapter three explains the methodology and also includes the model specification.

Chapter four covers the analysis of data. Chapter five discusses the summary and conclusion. 1. 12DEFINITION OF TERMS The key terms in this chapter include: Poverty: is the shortage of common things such as food, clothing, shelter and safe drinking water, all of which determine the quality of our life. Foreign aid: is the help provided to communities in the event of humanitarian crisis, or to achieve a socio economic objective. Economic development: is the qualitative change in economic wants, goods, incentives, institutions, productivity and knowledge or the “ upward movement of the entire social system. ”

Gross Domestic Product (GDP): is the total final output of goods and services produced by a country’s economy, within the country’s territory. Human

Development Index (HDI): is a composite index that ranks all countries based on three fundamental dimensions: longevity, educational attainment and standard of living. CHAPTER TWO LITERATURE REVIEW 2. 1DEFINITION OF POVERTY Poverty comes in the form of deprivation. It is when there is lack of the means to satisfy basic needs. According to the Penguin Dictionary of Economics, poverty is " the situation faced by people whose material needs are least satisfied".

It also specifies that " poverty exists not merely because the needs of some low-income households are high. People are poverty – stricken when their living standard falls radically below the community average. This implies that, such people cannot have what the larger society regards as the minimum necessity for decency. Poverty is a living condition characterized by disease, illiteracy, malnutrition and squalor, to the extent that it inhibits the realization of potentials of individuals and even entire societies.

It is therefore being regarded to as a socio-economic and political liability to any nation (Ekpo, 2000: 347). The poverty affects all aspects of a person's life: susceptibility to disease, limited access to most types of services and information, lack of control over resources, subordination to higher social and economic classes, utter insecurity in the face of changing circumstances, including its psychological effect – the erosion of human dignity and selfrespect. The effects of poverty can not be over emphasized.

It results into hunger, diseases, inadequate shelter and homelessness as part of the consequences of poverty. In our contemporary time, the poor man/woman has no voice in the society, lacks political influence, personal recognition; he is often emotionally and psychologically distressed and is always the downtrodden element in the society. (Fasoranti, 2008) 2. 2Concepts of Poverty Poverty is a multifaceted concept that manifests itself in different forms depending on the nature and content of human deprivation. It affects many aspects of human conditions, including; physical, moral and psychological.

Poverty is so broad that the literature referring to the efforts of defining and estimating poverty is greater than the one concerning the strategies for overcoming poverty. The concept of poverty answers the question of what is a sufficient degree of needs satisfaction and how it is established. Different criteria have been used to conceptualize poverty. Most analysis view poverty as a result of insufficient income for securing basic goods and services. Others view it as a function of education, life expectancy, health, and child mortality, etc.

According to Blackwood and Lynch (1994), poverty can be identified using the criteria of levels of consumption and expenditure. Sen (1983) relates poverty to entitlements, which are taken to be the various bundles of goods and services over which one has command, taking into cognizance the means by which such goods are acquired. Poverty can also arise as a result of inefficient use of common resources which is due to weak policy, environment, inadequate infrastructure, and weak access totechnology, credit, etc. Poverty can also be described as structural or transient.

Structural poverty (chronic poverty) is defined as persistent or permanent socio-economic deprivations. It is linked to factors such as lack of skills for gainful employment, limited productive resources, gender, endemic socio-political and cultural factors. Transient poverty, on the other hand, is defined as temporary or transitory and is linked to natural and man-made disasters. Transient poverty is more reversible but can become structural if it persists. Poverty was also conceptualized by Steeten and Burki (1978); broadly into four ways.

They include: • Lack of access to basic needs or goods; • Lack of or impaired access to productive resources; • Outcome of inefficient use of common resources; and • A result of “ exclusive mechanisms”. 3. CAUSES OF POVERTY Many different factors have been cited to explain why poverty occurs; but none of them has been able to gain universal acceptance. Possible factors include: Economic factors: 1. Recession: In general, the major fluctuations in poverty rates over time are driven by the business cycle.

Poverty rates increase in recessions and decline in booms. Extreme recessions, such as theGreat Depressionhave a particularly large impact on poverty. In 1933, 25% of all workers and 37% of all non-farm workers in the United States were unemployed. In New York, one child in every five was hungry. 2. Economic inequality: Even if average income is high, poverty rate will also be high if incomes are distributed unevenly. However the evidence on the relationship between absolute poverty rates and inequality is mixed and ensitive to the inequality index used. For example, while many Sub-

Saharan African countries have both high inequality and high poverty rates, other countries, such as India have low inequality and high poverty rates. In general the extent of poverty is much more closely related to average income than it is to the variance in its distribution. At the same time some research indicates that countries which start with a more equitable distribution of income find it easier to eradicate poverty through economic growth.

In addition to income inequality, an unequal distribution of land can also contribute to high levels of poverty. 3. Food prices and Poverty: Poor people spend a greater portion of their budgets on food than rich people. As a result poor households and those within the poverty threshold can be particularly vulnerable to increases in food prices. For example in late 2007 increases in the price of grains led to food riots in some countries. Decreases in food prices can also affect poverty although they tend to impact a different group - small farmers - than food price increases. 4.

Democracy and Poverty: When we look at social dimensions of development, access to drinking water, girls' literacy, and health care are starkly divergent. For example, in terms of life expectancy, rich democracies typically enjoy life expectancies that are at least nine years longer than poor autocracies. Opportunities of finishing secondary school are 40 percent higher. Infant mortality rates are 25 percent lower. Agricultural yields are about 25 percent higher, on average, in poor democracies than in poor autocracies—an important fact, given that 70 percent of the population in poor countries is often rural-based.

Poor democracies don't spend any more on their health and education sectors as a percentage of GDP than do poor autocracies, nor do they get higher levels of foreign assistance. They don't run up higher levels of budget deficits. They simply manage the resources that they have more effectively. " 5. Welfare states and Poverty: Currently modern, expansive welfare states that ensure economic opportunity, independence and security in a near universal manner are still the exclusive domain of the developed nations, ommonly constituting at least 20% of GDP, with the largest Scandinavian welfare states constituting over 40% of GDP. These modern welfare states, which largely arose in the late 19th and early 20th centuries, seeing their greatest expansion in the mid 20th century, and have proven themselves highly effective in reducing relative as well as absolute poverty in all analyzed high-income OECD countries. • The governance effectiveness of governments has a major impact on the delivery of socioeconomic outcomes for poor populations • Weak rule of law can discourage investment and thus perpetuate poverty. Poor management of resource revenues can mean that rather than lifting countries out of poverty, revenues from such activities as oil production or gold mining actually leads to a resource curse. •Failureby governments to provide essential infrastructure worsens poverty. • Poor access to affordable education traps individuals and countries in cycles of poverty. • High levels of corruption undermine efforts to make a sustainable impact on poverty. In Nigeria, for example, more than $400 billion was stolen from the treasury by Nigeria's leaders between 1960 and 1999 (Ribadu, 2007) 6.

Environmental Degradation: In many parts of the world, environmental degradation—the deterioration of the natural environment, including the atmosphere, bodies of water, soil, and forests—is an important cause of poverty. Environmental problems have led to shortages of food, clean water, materials for shelter, and other essential resources. As forests, land, air, and water are degraded, people who live directly off these natural resources suffer most from the effects. People in developed countries, on the other hand, have technologies and conveniences such as air and water filters, efined fuels, and industrially produced and stored foods to buffer themselves from the effects of environmental degradation.

Global environmental degradation may result from a variety of factors, includingoverpopulationand the resulting overuse of land and other resources. Intensive farming, for instance, depletes soil fertility, thus decreasing crop yields. Environmental degradation also results frompollution. Polluting industries include mining, power generation, and chemical production. Other major sources of pollution include automobiles and agricultural fertilizers.

In developing countries, deforestationhas had particularly devastating environmental effects. Many rural people, particularly in tropical regions, depend on forests as a source of food and other resources, and deforestation damages or eliminates these supplies. Forests also absorb many pollutants and water from extended rains; without forests, pollution increases and massive flooding further decreases the usability of the deforested areas. 2. 4MEASUREMENT OF POVERTY/INDICATORS Poverty is usually measured as either absolute or relative poverty (the latter is actually an index of income inequality). . 4. 1Absolute poverty: This refers to a set standard which is consistent over time and between countries. An example of an absolute measurement would be the percentage of the population eating less food than is required to sustain the human body (approximately 2000-2500 calories per day for an adult male). The World Bank defines extreme poverty as living on less than US $1. 25 (PPP) per day, and moderate poverty as less than $2 a day. Estimating that in 2001, 1. 1 billion people had consumption levels below $1 a day and 2. 7 billion lived on less than $2 a day.

Other absolute poverty indicators include: Life expectancy: According to Encarta encyclopedia, it is the average length of life that would be observed in a population in which the currently prevailing mortality risks at each age continued indefinitely. Infant mortality: Infant mortality rate is the probability of death in the first year of life, usually stated as a number per 1, 000 births. 2. 4. 2Relative poverty: According to Wikipedia, relative poverty views poverty as socially defined and dependent on social context, hence relative poverty is a measure of income inequality.

Usually, relative poverty is measured as the percentage of population with income less than some fixed proportion of median income. There are several other different income inequality metrics, for example the Gini coefficient or the Theil Index. Relative poverty measures are used as official poverty rates in several developed countries. As such these poverty statistics measure inequality rather than material deprivation or hardship. The measurements are usually based on a person's yearly income and frequently take no account of total wealth.

The main poverty line used in the Organization of Economic Cooperation and Development (OECD) and the European Union is based on " economic distance", a level of income set at 50% of the median household income. 2. 5Social Aspects of poverty Analysis of social aspects of poverty links conditions of scarcity to aspects of the distribution of resources and power in a society and recognizes that poverty may be a function of the diminished " capability" of people to live the kinds of lives they value. The social aspects of poverty may include lack of access to information, education, health care, or political power.

Poverty may also be understood as an aspect of unequal social status and inequitable social relationships, experienced as social exclusion, dependency, and diminished capacity to participate, or to develop meaningful connections with other people in society. The World Bank's " Voices of the Poor," based on research with over 20, 000 poor people in 23 countries, identifies a range of factors which poor people identify as part of poverty. These include: • Precarious livelihoods • Excluded locations • Physical limitations • Gender relationships Problems in social relationships • Lack of security • Abuse by those in power • Disempowering institutions • Limited capabilities • Weak community organizations 2. 6 FOREIGN AID The standard definition of foreign aid comes from the Development Assistance Committee (DAC) of the Organization of Economic Cooperation and Development (OECD), which defines foreign aids as financial flows, technical assistance, and commodities that are; designed to promote economic development and welfare as their main objective and are provided as either grants or subsidized loans. . 6. 1Humanitarian aid Humanitarian aid or emergency aid is rapid assistance given to people in immediate distress by individuals, organizations, or governments to relieve suffering, during and after man-made emergencies (like wars) and natural disasters. The term often carries an international connotation, but this is not always the case. It is often distinguished from development aid by being focused on relieving suffering caused by natural disaster or conflict, rather than removing the root causes of poverty or vulnerability.

The provision of humanitarian aid consists of the provision of vital services (such as food aid to prevent starvation) by aid agencies, and the provision of funding or in-kind services (like logistics or transport), usually through aid agencies or the government of the affected country. Humanitarian aid is distinguished from humanitarian intervention, which involves armed forces protecting civilians from violent oppression or genocide by state-supported actors.

The Geneva Conventions give a mandate to the International Committee of the Red Cross (ICRC) and other impartial humanitarian organizations to provide assistance and protection of civilians during times of war. The ICRC has been given a special role by the Geneva Conventions with respect to the visiting and monitoring of prisoners of war. The United Nations Office for the Coordination of Humanitarian Affairs (OCHA) is mandated to coordinate the international humanitarian response to a natural disaster or complex emergency acting on the basis of the United Nations General Assembly Resolution 46/182.

The Sphere Project handbook, Humanitarian Charter and Minimum Standards in Disaster Response, which was produced by acoalitionof leading non-governmental humanitarian agencies, lists the following principles of humanitarian action: • The right to life with dignity. • The distinction between combatant and non-combatants. • The principle of non-refoulement. 2. 6. 2Development aid Development aid is aid given by developed countries to support development in general which can be economic development or social development in developing countries.

It is distinguished from humanitarian aid as being aimed at alleviating poverty in the long term, rather than alleviating suffering in the short term. The term " development aid" is often used to refer specifically to Official Development Assistance (ODA), which is aid given by governments on certain concessional terms. It is given by governments through individual countries' international aid agencies and through multilateral institutions such as the World Bank, and by individuals through development charities such as Action Aid, Caritas, Care International or Oxfam.

In terms of dollars, the United States has consistently being the world’s largest donor (except in the mid-1990s when Japan briefly topped the list). In 2004, the U. S provided $19. 7 billion in ODA, with Japan, France, the United Kingdom, and Germany as the next largest donors, (including OA, the U. S provided a total of $21. 3 billion). However, when aid is measured as a share of donor income, the most generous donors are Norway, Denmark, Luxembourg, the Netherlands and Sweden, each of which provided between 0. 79- 0. 92% of GDP in 2004. Saudi Arabia provided aid equivalent to about 0. 9% of its income. The United States is one of the smallest donors by this measure at about 0. 17 percent of U. S income in 2004, just over half of the 1970 level of 0. 32% and less than one-third of the U. S average during the 1960s. Donors have pledged since the 1960s to devote 0. 7% of their income as aid, most recently at Financing for Development Conference in Monterrey, Mexico in March 2002, but only a handful of small donors have achieved this level of aid. The offer to give development aid has to be understood in the context of theCold War.

The speech in which Harry Truman announced the foundation of NATO is also a fundamental document of development policy: “ in addition, we will provide military advice and equipment to free nations which will cooperate with us in the maintenance of peace and security. Fourth, we must embark on a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas. More than half the people of the world are living in conditions approaching misery. Their food is inadequate. They are victims of disease. Their economic life is primitive and stagnant.

Their poverty is a handicap and a threat both to them and to more prosperous areas. For the first time in history, humanity possesses the knowledge and skill to relieve the suffering of these people. ” 2. 6. 3Specific types of Aid • Project aid: Aid is given for a specific purpose e. g. building materials for a new school. • Programme aid: Aid is given for a specific sector e. g. funding of the education sector of a country. • Budget support: A form of programme aid that is directly channeled into the financial system of the recipient country. • Sector wide Approaches (SWAPs): A combination of Project aid and Programme aid/Budget Support e. . support for the education sector in a country will include both funding of education projects (like school buildings) and provide funds to maintain them (like school books). • Food aid: Food is given to countries in urgent need of food supplies, especially if they have just experienced a natural disaster. • Untied Aid: The country receiving the aid can spend themoneyas they chose. It improves the government’s inter-temporal fiscal balance. • Tied aid: The aid must be used to purchase products from the country that donated it or a specified group of countries.

It always lead to deterioration, thus suggesting a potential tradeoff between consumer welfare and government solvency in the latter case. (Chatterjee and Turnovsky; 2005) • Technical assistance: Educated personnel, such as doctors are moved into developing countries to assist with a program of development. Can be both programme and project aid. OECD Categories The Organization for Economic Co-operation and Development's Development Assistance Committee puts foreign aid into three categories: • Official Development Assistance (ODA): is the largest, consisting of aid provided by donor governments to low- and middle- income countries. Official Aid (OA): is aid provided by governments to richer countries with per capita incomes higher than approximately $9000 for three consecutive years; and to countries that were formerly part of the Soviet Union or its satellites. • Other Official Flows (OFF): Aid which does not fall into the other two categories, either because it is not aimed at development, or it consists of more than 75% loan (rather than grant). 2. 7 POVERTY AND ECONOMIC GROWTH The impact on poverty on economic growth is problematic and is not clear.

It is indicated that effective anti-poverty action is difficult to achieve largely because the poverty problem is multidimensional, complex and location specific deeply rooted into the social fabric and distribution of economic and political power (Tarp, 2000). One implication of these is that donors as well as analysts of the impact of aid on poverty need to be realistic about the severity of the difficulties that are likely to be encountered and the scale of effort needed to overcome poverty.

Most evaluations have shown that achievements in this area are modest at best. In general, it was found that there is a wide gap between the stated commitments to poverty reduction and the actual practices of reducing poverty in the field. Most donors have paid little attention to conceptualization and analysis of poverty and have been particularly weak in translating the poverty reduction objective into operational guidance and in their country assistance strategies. Similar pitfall applies to most analysis of the impact of aid on poverty.

The main instruments of donor intervention has been a series of ad hoc projects and in these improvements have been observed over time in respect of participation by beneficiaries and gender sensitivity but few donors have been concerned about sustainability. 2. 8FOREIGN AID AND ECONOMIC GROWTH Most foreign aid is designed to meet one or more of four broad economic and development objectives. • To stimulate economic growth through building infrastructure, supporting productive sectors such as agriculture, or bringing new ideas and technologies; • To strengthen education, health, environmental or political systems; To support subsistence consumption of food and other commodities, especially during relief operations and humanitarian crises; • To help stabilize an economy following economic shocks. Despite these objectives for aid, economic growth has always been the main yardstick used to judge aid's effectiveness, with more aid expected to lead to faster growth. But at a broad level, there is no apparent simple relationship between aid and growth. The absence of a simple relationship means that for some observers, it is an evidence of a failure of aid to achieve its basic objectives.

But for others, it is misleading, as other factors affect both aid and growth. Not surprisingly, the views on the economic impact of foreign aid on poor countries turn out to be highly divided. Some papers, e. g. Rwabutomize(2008) and Cato Institute (2004)) totally oppose the notion that foreign aid has beneficial effects on developing economies and even go as far as saying they indeed hinder growth. Others like Karras (2006), Durbarry, Gemmell & Greenaway (2004) and Wangwe (2004) find a positive relationship between the two. Yet a lot of research finds conditional relationships between the two variables.

This section gives a summary of the views from the examined relevant and available literature on this subject. 2. 9Economic impact of foreign aid in theory The impact of foreign aid on recipient countries' economies has been a subject of research and debate among scholars and policymakers for more than five decades. There are two obvious stands in the literature of foreign aid effectiveness: one argues that foreign aid spurs growth and development of the recipient countries while the other opposes this view by arguing that aid crowds out savings and investments and thus slows down economic growth.

There is also another stand that proposes that foreign aid has a conditional relationship with growth, accelerating growth only under some certain circumstances. A possible reason for the high variability of opinions on the benefits of foreign aid is that there is no generally accepted theory on the workings of foreign aid. Frameworks like the gap theory have been widely criticized in contemporary research leaving the employed frameworks highly subjective. Simon (1987) offers five criteria for economic aid disbursement. First, the recipient person or nation " needs" the help.

Second, the recipient wants the help. Third, the gift will not have bad effects in the long run on the recipient or others. Fourth, the charity will be used more-or-less efficiently rather than largely wastefully or simply to obtain more money in a pyramid scheme. Fifth, the charity will not be useless tothe giver. In addition, a lot of the conditional relationship between foreign aid and economic development is premised on differentiation of foreign aid categories. For instance, Annen and Kosempel (2007) differentiate between foreign aid as technical assistance (TA) and non-technical assistance (NTA).

They believe that the policies which will be most effective in reducing international income disparities will be the ones that help reduce the productivity gap, and this is exactly what technical assistance is intended to do. They also explained that when foreign aid takes the form of technical assistance, it can have important effects on improving economic conditions in poor countries; at least when it is administered efficiently. Chatterjee and Turnovsky (2005) in their work classified foreign aid into ‘ tied’ and ‘ untied’.

They posit that the link between foreign aid, economic growth, and welfare depends crucially on the mechanism through which a particular aid program, whether tied or untied, is absorbed by the recipient economy. 2. 9. 1Dissenting views On the other hand, the Cato Institute (2004) actually proffers negative economic impact. In their opinion: • There is no correlation between aid and growth. • Aid that goes into a poor policy environment doesn’t work and contributes to debt. • Aid conditioned on market reforms has been a failure. • Countries that have adopted market-oriented policies have done so because of factors unrelated to aid. There is a strong relationship between economic freedom and growth. • Even aid intended to advance market liberalization can produce undesirable results. Such aid takes the pressure off recipient governments and allows them to postpone, rather than promote, necessary but politically difficult reforms. Easterly (2003) challenges the growth gap theory usually used to justify increase in foreign aid. He states that the " financing gap" model in which aid increases investment and that investment increases economic growth has dubious theoretical foundations and numerous empirical failings.

It assumes a stable linear relationship between investment and growth over the short to medium term but there are sound reasons to doubt whether the incremental capital-output ratio is constant and thus whether the relationship from investment to growth is linear. A second key assumption of the model in which aid fills a financing gap and allows greater investment is that aid will actuallyfinanceinvestment rather than consumption. This assumption will hold true only if investment is liquidity-constrained and incentives to invest were favourable.

Another opponent of the gap theory is Erixon (2005). He carried out a literature analysis of aid and economic growth by examining case studies of countries who have received considerable amounts of aid. He also contends that the reason countries are poor is not that they lack infrastructure; roads, railways, dams, schools or health clinics. Rather, it is because they lack the institutions of the free society: property rights, the rule of law, free markets, and limited government. He maintains that even in the face of sound policy, foreign aid fails to have the desired effect.

According to him, there is much evidence supporting the view that aid largely has backed political regimes with little interest in growth and development. It would be much more sensible to scale back the levels of aid considerably; provide aid only to governments that are already reforming and agree to continue reforms; and make clear that aid will be available only for a strictly limited period. M'Amanja & Morrissey (2004), in their study contend with foreign aid–economic growth relationships based on the often wrong theoretical assumptions used as a basis for it.

With respect to the stipulations of endogenous growth theory, high investment ratios do not necessarily lead to rapid economic growth; the quality of investment, its productivity, existence of appropriate policy, political, and social infrastructure are all determinants of the effectiveness of investment. Time series was used to investigate this relationship in the Kenyan economy. They focused on one element of growth and used a multivariate approach on time series data for Kenya over the period 1964 – 2002 to investigate the growth effects of foreign aid, investment and a measure of international trade.

In addition, some opposition to foreign aid comes from social biases. An example is Mutambara (2008) who claims that although the stated intention is ostensibly to assist the poor economies, most foreign aid benefits the donor countries. The modus operandi has been that the rich West provides financial assistance or loans to poor nations to engage Western consultants or institutions to carry out unsustainable and useless projects on the continent.

As a result, there is minimum benefit to the African country while the money is recycled back via western institutions. The Cato Institute (2004) gave its position based on economic freedom. They assert that the greater a country's economic freedom, the greater its level of prosperity over time.

Economic freedom, which includes not only policies, such as free trade and stable money, but also institutions, such as the rule of law and the security of private property rights, does not only increase income.

It is also strongly related to improvements in other development indicators such as longevity, access to safe drinking water, lower corruption, and lower poverty rates. Radelet (2006) examines aid magnitudes and who gives and receives aid. It discusses the multiple motivations and objectives of aid, some of which conflict with each other. It then explores the empirical evidence on the relationship between aid and growth, which is divided between research that finds no relationship and research that finds a positive relationship (at least under certain circumstances).

It also examines some of the key challenges in making aid more effective, including the principal-agent problem and the related issue of conditionality, and concludes by examining some of the main proposals for improving aid effectiveness. Karras (2006) investigates the relationship between foreign aid and growth in per capita GDP using annual data from the 1960 to 1997 period for a sample of 71 aid-receiving developing economies. More specific studies like Asiedu and Nandwa (2004) focused on whether foreign aid in education has a significant effect on growth.

In carrying out their study on the effect of foreign education aid they took into consideration the heterogeneous nature of aid as well as the heterogeneity of aid recipients—they disaggregated the aid data into primary, secondary and higher education, and ran separate regressions for low income and middle income countries. Neanidis and Varvarigos (2005) examined the effects of aid transfers and their degree of volatility (different kinds of variability) on economic growth. They conducted regression analysis for a panel of 74 aid-recipient countries over the time period from 1972 to 1998.

Bhandari et al. (2007) carried out a region specific study the effectiveness of foreign aid and foreign direct investment in the Czech Republic, Estonia, Hungary, Latvia, Lithuania and Poland. They used a model that includes the labour force, capital stock, foreign aid and foreign direct investment, and is estimated using pooled annual time series data from 1993 to 2002. Before carrying out the estimation, the time series properties of the data were diagnosed and an error-correction model was developed and estimated using a fixed-effects estimator.

Inanga and Mandah (2008) examines the role of two foreign aid financing agencies, Enterprise Development Fund (EDF) and Export Development Programme (EDP), in promoting Zambia’s economic growth in a country study. They assessed and analysed the impact of each of them on the growth and development of different sectors of the Zambian economy. The sector impact analysis included manufacturing, agriculture, transport, and institutional capacities.

Al Khaldi (2008) analyses the trend and impact of foreign aid on the economic development of Jordan during the period 1990-2005 using for this purpose different statistical techniques. Chatterjee and Turnovsky (2005) introduced two crucial aspects of this mechanism that have been absent from previous work: the importance of the endogeneity of labor supply as an additional margin through which foreign aid may impact on macroeconomic performance; and the role played by the interaction of labor supply and public capital; and externalities associated with public capital accumulation in determining an economy's response to a foreign aid shock.

They suggest that when donors decide on whether a particular aid program should be tied to an investment activity, careful attention should be paid to the recipient's opportunities for substitution in production, the elasticity of labour supply, and production externalities. It is perfectly possible for a tied transfer to have a presumably unintended adverse effect on the recipient economy, if that economy is structurally different from what the donor perceived. Durbarry, Gemmell and Greenaway (2004) assessed the impact of foreign aid on growth for a large sample of developing countries.

They used an augmented Fischer-Easterly type model and estimated this using both cross-section and panel data techniques. This allowed them to identify not only the ceteris paribus growth effects of aid using an established conditioning set of policy variables, but also to assess the robustness of this set to the inclusion of aid, and other forms of, investment finance among the growth determinants. Annen and Kosempel (2007) tested the hypothesis that the effectiveness of aid depends on its level of fragmentation.

The study presented a theoretical growth model for a small open economy that was capable of identifying the appropriate specification required for an aid-growth regression. 2. Empirical findings Annen and Kosempel (2007) found that non technical aid (NTA) has no statistically significant impact on growth; but technical aid (TA) has a positive and significant impact, except in countries where it is highly fragmented. A possible explanation for this result is that the savings rate applied to NTA is low, and therefore most of these resources are used to finance consumption instead of investment.

Although the policy interaction term for NTA was found to be positive, as expected; the partial impact of NTA conditional on policy was found not to be statistically significant for any policy level. When aid takes the form of TA our results showed that it has a strong positive and statistically significant impact on economic performance. Specifically, their estimates show that for the average developing economy a 25% increase in TA will lead to about a quarter percentage point increase in its yearly growth rate.

Their estimates indicate that when the level of fragmentation is high - above 73%, the partial impact of TA on growth is zero or even negative, depending on the estimation procedure. Asiedu and Nandwa (2004) also gave a conditional aid – growth relationship. They report that the effect of aid varies by income as well as by the type of aid. These results underscore the importance of the heterogeneity of aid flows as well as the heterogeneity of recipient countries when analyzing the effect of aid on growth.

Aid depends on the level of development of the recipient country (low and middle income) as well as the level of education at which aid is being targeted (primary, secondary or higher). Aid in primary education enhances growth in low income countries but aid in post-primary education has no significant effect. For middle income countries, aid in primary education and secondary education has an adverse effect on growth but aid in higher education enhances growth.

Thus, their results highlight the importance of taking into account the heterogeneity of aid and the heterogeneity of the recipient countries when analyzing aid-growth relationships. Sound policy is another condition given for aid to be beneficial. In the view of Al Khaldi (2008), policies are also important in the effectiveness of the foreign capital inflow, as aid has a more positive impact on growth with good fiscal, monetary and trade policies.

In the presence of poor policies, on the other hand, aid has no positive effect on growth. Accordingly, there is a need of not only good policies but also the implementation of these policies as well as the proper monitoring of the aid -utilizing projects is necessary in order to avoid the mis-utilization and the mismanagement of the foreign capital resources. However, according to M’Amanja & Morrissey (2004), aid in the form of net external loans is found to have a significant negative impact on long run growth.

Private investment relates to government investment and imports negatively, but positively to foreign aid though they note that the negative association between aid and growth may be due to their use of aid loans rather than grants.. Private investment has been a consistently strong determinant of growth both in the short- and long- run. The implication here is that in order to stimulate and sustain economic growth in Kenya, policy makers need to pay closer attention to factors that determine private investment.

However, some findings disregard these conditions and oppose the benefits of foreign aid altogether. The results from Bhandari et al. (2007) indicate that an increase in the stock of domestic capital and inflow of foreign direct investment are significant factors that positively affect economic growth in these countries. Foreign aid did not seem to have any significant effect on real GDP. Rwabutomize (2008) reports that empirical findings reveal that foreign aid has no impact on economic growth amongst the low-income economies under investigation within the Sub-Sahara Africa region from 1990-2004.

He concludes that the growth process of poor economies have not benefited from the official development assistance (foreign aid) inflows and increasing aid will not have a positive impact of growth either. Thus these economies should rely on other development resources other than foreign aid such as their domestic savings and tax revenues. Radelet (2006) came up with similar conclusions. Aid can keep bad governments in power for too long, and can undermine incentives for saving, tax collection, and private sector production.

Aid relationships are made much more difficult by a complex chain of principal-agent problems that weaken information flows, introduce myriad motivations for different actors, and make monitoring andaccountabilitymore difficult. Inanga and Mangah (2008) in their study support these findings. According to them, although Zambia has, on the average, received aid of about US$ 514 million annually over the past three decades, its per capita income has declined from US$1, 251 in he early 1970s to about US$ 600 in the late 1990s. They concluded that although it may be difficult to separate the effects of foreign aid finance from those of other growth-inducing factors, efficient and effective utilization of foreign aid finance can contribute to growth in a stable macroeconomic environment. As stated already, not all findings opposed the notion of beneficial foreign aid. The results from Karras (2006) show that the effect of foreign aid on economic growth is positive, permanent, statistically signi? ant, and sizable: raising foreign aid by $20 per person of the receiving country results in a permanent increase in the growth rate of real GDP per capita by approximately 0. 16 per cent. Using an alternative foreign-aid measure, a permanent increase in aid by 1 per cent of the receiving economies GDP permanently raises the per capita growth rate by 0. 14 to 0. 26 per cent. Wangwe (2009) states that a survey of three generations of empirical work found a consistent pattern of results. It found that aid increases aggregate savings, aid increases investment and there is a positive relationship between aid and growth in reduced form models.

In Durbarry, Gemmell and Greenaway (2004) results vary according to income level, levels of aid allocation and geographical location. They report a positive coefficient on foreign aid as defined by the Organization for Economic Co-operation and Development (FAIDOECD) in 1993 as a percentage of the gross domestic product (GDP), significant at 10%. Point estimates indicate that raising the aid/GDP (or domestic savings/GDP) ratio by one percentage point raises the growth rate by about 0. 10 percentage points.

Finally, adopting an alternative measure of foreign aid - aid per capita – yields similar results, confirming a positive and significant impact on growth. Panel data also yields similar results. And lastly according to Neanidis and Varvarigos (2005), on the one hand, devoting aid inflows into productive public spending promotes growth while the related volatility has a damaging effect. On the other hand, the non-productive use of aid transfers has an adverse effect on growth while their volatility is growth-enhancing. They proffer that the general onclusion emerging from their analysis can be summarized as follows: when aid is used productively (unproductively) it has, on average, a positive (negative) effect on growth while its respective volatility has a negative (positive) growth effect. Our results propose that recipient countries should allocate the aid they receive on the most productive uses, while donors should make sure that aid provision is the least erratic possible. 2. 10 DEFINITION OF TERMS Economic growth: For the purpose of this study, economic growth will be represented by the annual Gross Domestic Product at current factor cost.

Labour force: Labour in this context consists of the number of people aged 15 and over who are employed (that is those who currently have jobs).

Individuals who do not fall into either of these groups such as the unemployed, retired people and discouraged workers are not included in the calculation of the labour force. Unemployment: The International Labour Organization (ILO) defines unemployment as the proportion of the labour force which was available for work but did not work for at least one hour in the week preceding the survey period. However, the definition used here is that of the National Bureau of Statistics (NBS), Nigeria.

The NBS defines unemployment as the proportion of the labour force that is available for work but did not work for at least 39 hours in the week preceding the survey period. Foreign Aid: is the economic help provided to communities of countries due to the occurrence of a humanitarian crisis or for the achievement of a socioeconomic objective. Foreign direct investment (FDI): FDI is an investment in real assets where real assets consist of physical things such as factories, land, capital goods, infrastructure and inventories. CHAPTER THREE THEORETICAL FRAMEWORK AND METHODOLOGY . 1INTRODUCTION The aim of this study is to examine the relationship between foreign aid and economic growth in Nigeria. This section starts with a theoretical framework then continues with a description of the model to be used for quantitative analysis. The regression is run using Ordinary least squares technique. The theoretical framework of this study is taken from theories, concepts, views and models. 3. 2THEORETICAL FRAMEWORK This study uses the theoretical framework employed by Ogbuaku, Adebisi and Feridun (2006) based on the neoclassical growth model by Barro (1991).

It is based on a small open economy version of the Solow (1956)-Swan (1956) growth model. The decision to study foreign aid in an open economy, as opposed to a closed, is three fold. First, most of the economies that receive foreign aid must reasonably be considered small and open. Second, to the extent that international credit markets are imperfect, some forms of foreign aid can have a positive impact on the poor. Third, in our empirical work we provide statistical evidence to suggest that greater international openness and access to credit stimulates economic growth. The two-gap model can also be employed.

The first gap is the gap between the amount of investment necessary to attain a certain growth rate and the available domestic saving. Easterly (2003) examined the investment-savings gap. It goes thus: economic growth depends on investment as a share of GDP, adjusted by a factor that reveals whether investment is of high or poor quality. The amount of investment will be the sum of domestic savings and foreign aid. The model of the " financing gap" approach thus makes two key assumptions. First, it assumes the above stable linear relationship between investment and growth over the short to medium run.

This assumption grows out of a Leontief-style production function with fixed requirements for capital and labour per unit of output. A second key assumption of the model in which aid fills a financing gap and allows greater investment is that aid will actually finance investment rather than consumption. This assumption will hold true only if investment is liquidity-constrained and incentives to invest were favourable. If the cause of low investment is due to poor incentives to invest, then aid will not increase investment. (Easterly, 2003) . 3 RESTATEMENT OF RESEARCH HYPOTHESIS H0: Foreign aid has no significant impact on the reduction of poverty and hence the economic growth of Nigeria. H1: Foreign aid has a significant impact on the reduction of poverty and the economic growth of Nigeria. 3. 4 RESEARH DESIGN 3. 4. 1MODEL SPECIFICATION This study uses the theoretical framework employed by Ogbuaku, Adebisi and Feridun (2006) based on the neoclassical growth model by Barro (1991). They specify a simple model of poverty and globalization as follows: POV = ? 0+1 ? TRADE+ ? FDI+ µ……………………………………(1) This model is augmented to include the foreign aid element thus: POV = ? 0+ ? 1TRADE+ ? 2FDI + ? 3AID+ µ………………………(2) Where POV is the yearly average per capita income trade is import + export /gdp fdi is foreign direct investment aid is foreign aid µ is the stochastic error term 2. SOURCES OF DATA The analysis will be based on time series data of AID, TRADE, FDI and POV for the Nigerian economy for the period 1981 - 2007. These are secondary data collected from publications of Central Bank of Nigeria such as statistical bulletin and annual reports. 4. METHOD OF DATA ANALYSIS

As stated in the introduction to this study, the Ordinary Least Squares (OLS) method of regression analysis is used in this research work. The OLS is one of the most commonly employed and most important methods in estimating relationships in econometrics. Furthermore, to contain the problems associated with time series data, a unit root test; the Augmented Dickey-Fuller (ADF) test, is employed to test for stationarity. Other methods applied include Johansen co-integration and error correction model. 3. 5. 1Augmented Dickey-Fuller (ADF) test Augmented Dickey-Fuller (ADF) test is used to test the stationarity in time series.

Stationarity refers to the constancy in mean and variance of time series over a period of time. This will enable us to know if there is co-movement in time series in long run equilibrium. It is the augmented version of the Dickey-Fuller test for a larger and more complicated set of time series model. Stationarity test reveals the presence or absence of random-walk (unit root) in regression analysis. If the time series are non-stationary it means that our regression is spurious and as such estimates cannot be used to predict future values. The time series can then be adjusted in order to make them stationary.

The augmented Dickey-Fuller (ADF) statistic used in the test is a negative number. The more negative it is, the stronger the rejections of the hypothesis that there is a unit root at some level of confidence. 3. 5. 2Johansen Co-integration This especially has been developed to overcome the problems of spurious regression which is associated with non-stationary time series data, in such instances, econometric results may not be ideal for policy making. The theory of co-integration arises out of the need to integrate short run dynamics with long run equilibrium.

In cases where the data series exhibit the presence of unit roots, short-run dynamics properties of the model can only be captured in an error correction model when the existence of co-integration has been established. On this note, if variable are co-integrated, it shows that such variable possess the capacity to reach equilibrium in the long run. 5. LIMITATIONS TO THE STUDY Using economic growth as a measure of the influence of foreign aid on poverty in Nigeria assumes that there is adequate distribution of wealth in the Nigerian economy such that gains in economic output is transmitted to poor areas.

It is possible that this is not the case. In addition, it is necessary to note that the use of regression techniques always comes with limitations. The first is the common warning that correlation does not mean causation. Therefore, even if a relationship is established between the examined variables, this does not guarantee that the occurrence of one necessitates the occurrence of the other. CHAPTER FOUR EMPIRICAL ANALYSIS AND PRESENTATION OF DATA 4. 1 INTRODUCTION In this chapter, the statistical data gathered during the course of this research work is subjected to investigation and analysis.

The chapter starts with the brief explanation of various criteria for decision making, followed by the analysis of the static regression equation. In order to test for the presence of unit root (i. e. , spuriousness) in the static regression equation, stationarity test would be conducted using Augmented Dickey Fuller Test (ADF), while co-integration test using Johansen Co-integration test would also be conducted in order to establish the long-run co-movement among the variables. Finally, the error correction model will be used to test the relationships between the variables. . DECISION MAKING CRITERIA The following criteria for decision making are used in the analy