

# INDIA AND FOREIGN AID - FROM RECIPIENT TO DONOR

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## **Abstract:**

*India is one of the largest and fastest economies in the world. Initially it was a recipient of foreign aid and gradually it transformed into a donor. The purpose of this paper is to discover the effect of transformation of India from a recipient to a donor. This has been done by examining different economic indicators like GDP, HDI and exports with foreign aid given and aid received. Upon examination of these indicators using Pearson's correlation method, it has been clear that there is no relationship exist between these indicators and aid received and given expect in the case of foreign aid received and HDI. This paper also provide an insight that how different countries like China, Japan and South Korea underwent transformation from recipient to donor.*

**Keywords:** Foreign Aid, Recipient, Donor, India, Pearson's Correlation

## **I. Introduction**

The evidences of foreign aid can be traced back to 19th century. The practice at that time was that rich countries provided aid facilities of different forms and kinds to poor countries; which is more or less similar in present century too. During 1920s and 1930s it is observed that countries like Germany, France, and Britain provided aid to its colonies in Africa, Latin America and Asia for advancing their infrastructural facilities like ports, roads, railways etc. which in turn benefited the colonial donors. This arrangement continued even after their independence. Post-cold war era the nations were classified into 3 categories namely western democrats, Soviet Union and third-world countries (includes all those colonized countries) (Keri, 2013). The first form of well-shaped aid program refers to the Marshall plan (1948) that was introduced by US to rebuild Europe. After which soon overseas aid got formalized and organized with the interference of the World Bank, IMF, UN and other international institutions. Committees like DAC (development assistance committee) initiated a systematic program of aid allocation called as ODA (official development assistance) complying with the MDG (millennium development goals) of UN.

However, it is to be noted that though the terms aid, investment and donations are used alike in common parlance they hold significant differences. While aid refers to funds that are made available to struggling nations by countries that have the necessary financial strength. This aid takes form of low-interest loans, grants, relaxed trade policies, preference in terms of trade agreements, technological know-how, equipment transfers (including military equipment) medical and food supplies. Investments are those rendered with an aim of making profits whereas donations are mere form of extended charity. (Source: Difference between Foreign Aid and Foreign Investment. (**Differencebetween.com**))

## **II. Review of literature**

The focus of this paper is on aid growth relationship at macro level. To heighten the accuracy of aid-growth studies the author has brought an alternative methodological and econometric procedure to increase the accuracy of aid-growth studies. Unlike most prevalent studies she had proposed a methodological and econometric procedure. The conclusion of this paper is similar to that of the micro results, and common macro result of cross-country regression studies published in last few years; economic growth of developing countries is fueled by foreign aid. (**berthault, 2005**)

The author in this paper focuses on large sample of developing countries to analyze the impact of foreign Aid on growth. He has used the Fischer-Easterly type model and both cross-section and panel data techniques. The Authors conclude by stating that the external economic environment plays a vital role in the growth performances of developing countries. Their research suggests that the inclusion of policy variables provides a more fully specified model but aid-growth effects are not dependent on it. (**DURBARRY RAMESH**)

In this paper it is seen that recent studies showing that aid's which are aimed at social and economic sectors often merely substitute the spending that recipient governments should have undertaken anyways, the funds that are generated are spent for other purposes. The increasing concern of donor community is whether the aid's that is earmarked for economic and social sectors are being used directly or indirectly for unproductive expenditures like defense etc. Public Expenditure Reform Loan (PERL) at the World Bank is an alternative option which replaces all project loans to a country with direct budgetary support, based on an agreement about the quality of the country's public expenditure program. Converting all lending into a single instrument such as PERL is certainly an improvement. (**Vinaya, 1998**).

In this paper the scholars have found out that the foreign aid is mainly flowing in respect of political and strategic considerations rather than by means of economic needs and policy performances of the recipient countries. The foreign aid addresses more of political variables whereas the so called FDIs are more sensitive towards economic incentives. The paper also unfolds differences in behavioral pattern of donors. (**Dollar, 2000**).

The author of this paper argues that the infusion of foreign aid act as a catalyst for economic reforms only when the strategic benefits derived from the aid by donor countries is small. The paper addresses the question of foreign aid & effectiveness. Quoting the example of western governments, it is found that the aid levels were mainly determined by strategic military and political interest of donor governments. It is identified in pre and post-cold war era. **(Daniel, 2010).**

In this particular research paper the author tries to identify the relation between foreign aid and economic development. He uses different econometrics models in order to analyze the aid-growth relationship. He made different studies like 'Burnside and dollar' study which says that aid encourages growth in countries with good policy environments like low inflation, low budget deficit etc. At the end, he concludes the research paper by mentioning that there is no conclusive evidence that these two are positively or negatively correlated because of the weakness of the models s being used to assess the relationship. **(Lawrence, 2011)**

### **III. Objectives**

The main objective of undertaking this research study is to analyze the impact of transformation of India from an aid recipient to an aid donor. From the words of Andreas Fuchs and Krishna Chaitanya Vadlamannati (April 2012) India is a needy donor.

The primary objectives of the study are supported by the following:

1. To understand how a change from recipient to donor affects the economy in selected countries.
2. To discover the relation between the transformation from aid recipient to aid donor and selected economic indicators in India.
3. To identify the ideal position for India to be in.

### **IV. Scope**

Aid is an inevitable part of growth map of every country. There are key donors of aid like United States of America and major recipients like Ethiopia and other African countries. Then there are countries like India which are recognizing itself as an aid donor. Rather than walking merely in the path of receiving aids the study focuses on these countries and identifies their relation between socio-economic variables. The paper analyses 3 different countries namely China, Japan, and South Korea for understanding the transformational impact and extends to a detailed study of the scenario in India.

### **V. Importance / Need for the study**

To identify the impact of infusion of aid into an economy, as well the cost it bears and benefits it generates while dispensing aid to other economies. Since most of the general public is unaware of the allocation of aid, where it is utilized and if it is benefiting them this study holds high rate significance in present scenario.

## **VI. Research gap**

1. Most of the papers focus on the improvement in relationship between the donor country and recipient country.
2. None of the papers we reviewed have analyzed the internal changes that happen within the countries like changes in GDP, quality of life, exports etc.

## **VII. Statement of the problem**

India is turning out to be a significant donor for developing countries; but the problem we focus on is whether India is capable of making foreign aid contribution when majority of its own people are lacking behind basic amenities. The various human development indices still show that India has a long way to go before becoming a significant donor for development assistance of other countries.

## **VIII. Research methodology**

The collection of data consists of only secondary data. It was collected from various online institutional websites like OECD, AIDDATA, World Bank, MEA and from research papers, journals and articles on the concerned topic. The data collected then are analyzed and interpreted with the help of Pearson's correlation method to arrive into conclusions.

- **Sample size**

The study is country specific. We have analyzed 3 notable countries which in similar to India underwent transformation from an aid recipient to aid donor. The 3 countries are as follows:

1. China
2. Japan
3. South Korea

- **Limitations**

Primary data collection is quite impossible or not practical which restricted the research to be based on the information available on internet and pre-published journals or articles. Also, the latest updates are not available for arriving at cent percent conclusion. This paper only takes official data flows into consideration.

## **IX. Case Study**

- *South Korea*

After the Korean War the country was struggling to rebuild itself before emerging in rags to riches tale. Today South Korea is the 8<sup>th</sup> largest economy in the world and also the 7<sup>th</sup> country in the world to join the

“20-50 club”. The Korean market share for electronics have also grown drastically like the Samsung smart phone; the main competitor of apple iphone, started off as a small enterprise with 35 employees today is a market giant in such a small period of time.

Under the support of European Union the treaty of European Union was set up with the primary objective of eradication of poverty.

The following table shows the inflow of ODA to South Korea:

Year	1969	1979	1989	1995
ODA inflows In mil. US\$	2300	400	90	10

From the above table it is clear that ODA inflows to South Korea had declined drastically over the period of 1969-95. The Korean aid mainly goes to Asia, especially Iraq, Vietnam, Indonesia and Sri Lanka. As per the ‘2018 Annual Implementation Plan for Development Cooperation’, Korean aid is expected to focus on five sectors: industrialization; water, sanitation, and hygiene (WASH); health; education; and agriculture.

The following table shows the contributions made by south Korea towards ODA which clearly shows that the contribution made by South Korea towards ODA had rapidly increased over the period from 1989-2011.

Year	1989	1995	2005	2011
ODA outflow	40	100	780	1350

The South Korean aid given is the lowest of all ODA members (as a percentage of GNI), but the Korean rate of 0.12 per cent of GNI should not be underestimated as the Korean ODA is rapidly increasing in such a pace that it has almost matched with the traditional members like US and Japan. The aim of South Korea is to attain a GNI percentage of 0.2 by the year 2020. As the contribution towards ODA by South Korea increases we can find that poverty in the country had reduced drastically till 1990's and is one of the fastest poverty eradication that world had witnessed. This is because of rapid economic growth and increase in foreign aid contribution to developing countries which attracted foreign investors to South Korea. But on the other hand the poverty among the retirement age population has increased from 2005-12. This is because South Korea attracted foreign investors which created employment opportunities in the country but only for the working population. In September 2017, South Korea decided to propose an aid of USD 8 million to North Korea.

Date	Quarterly GDP	Q. GDP Growth (%)	Q. GDP Annual Growth (%)
2017Q4	283,478M. \$	-0.2%	2.8%

2017Q3	282,083M. \$	1.4%	3.8%
2017Q2	380,287M. \$	0.6%	2.7%
2017Q1	324,952M. \$	1.0%	2.9%

The above table shows that the GDP growth in 3<sup>rd</sup> quarter of 2017 is comparatively higher than the rest three quarters due to the proposal of foreign aid to North Korea. 50% of the GDP of South Korea is from exports and 2/3rd of its exports are to developing countries, in short the country is highly export depended. The share of manufacturing sector in GDP is also significant in the country. South Korea had taken steps to improve its trade using Free Trade Agreements (FTA) with countries including United States and the European Union. This kind of free trade with various countries is only possible with good relationship with them this is attained by South Korea through inflow and outflow of foreign aid for improvement of human lives.

South Korea is ranked 15<sup>th</sup> in the latest Human Development Index. The quality of life in South Korea has improved significantly over the period of time; almost 83% of its population lives in urban area. The life expectancy at birth is 82 years which is higher than most of the countries and the unemployment rate are also low compared to other countries.

#### • *China*

Despite being an economic super giant China too dates back to a time being an aid recipient. Since 1949 bilateral and multilateral aid are occurring between china and other countries. The amount received as aid in early years of independence was diverted to the advancements of socio-infrastructures. It is noticeable that China has gradually cut down the assistance getting from other nations and has managed to maintain a steady growth in its outflow of aid assistance program.

Researchers found out that the transformation of china from an aid recipient to donor are part of important strategic decisions. Chinese government views aid assistance as a key tool of their foreign policy, a gambit to win political support around the globe. According to the whitepaper by Chinese government, china has provided aid assistance nearing 400 billion Yuan (\$58 billion) in 2016. However it is to be noted that aid policies adopted by china is not traditional but mostly commercial projects and loans requiring repayment with interest. China dispenses its aid based on political benefits. It is criticized that china's aid programs are not equitably distributed. It mainly concentrates on that part where influential personnel's are located opposed to marginalize regions where aid actually is in need. China is said to follow this trend in order to access the foreign markets to boost their export business and to overshadow United States, who currently are the economical and financial superpower.

It is understood that even though china has undertaken several high end aid programmes it has not compromised in its socio-economic factorial indicators. The number of people below poverty line is gradually decreasing over the years. This in turn with other factors has catalyzed the increment in the HDI rank of china. China holds the 86th rank in HDI with score of 0.752 compared to 0.63 in 2004. Also, it is notable that aid programmes have highly helped china to improve its export business. It is observed that china's average export business is higher than the world average. Thus, we can say that china has managed to go hand in hand in their overseas aid programmes as well as their national development procedures. The results show that their transformation has not created much of a fuss in their economy rather boosted their relation with other nations.

### • JAPAN

Japan is one of the largest aid donors in the world over the past 30 years. Initially they were only receivers of aid but later they started contributing. During the period of 1945-1953, Japan was a well-known recipient of economic assistance from the United States and the World Bank and later from 1954 onward they became donors to different African countries and others like Srilanka, China and India etc.

As we seen Japan was a recipient of foreign in initial period and they have used it for the makeover and rehabilitation of the economy. They allocated these foreign aids for the implementation of numerous infrastructural initiatives like transportation system and power generation plants. Since the economy was weak due to the effect of Second World War, they utilized the aids to rebuild the war torn economy to be more stable. During the pre-donor periods there was a shortage of food and other daily necessities and the assistance was also received for meeting the same. Amounts of food received through GARIOA (Government aid and relief in occupied areas was a program under which the US after the end of the second world war which provided emergency aid to the occupied nations, Japan, Germany, Austria) was around \$1577.5 million which was the one the aid received by the Japan during the time of post-world war II.

As understood the recipient status of Japan is less because it was only receiving the aid from United States and other countries only till the period of 1960s after which it started providing aids. By the 1960s, along with the incoming aids into country they had achieved a substantial economic growth. They have started giving aids to different countries and Japan's net official development assistance stood at US \$11.9 billion in 2017 making Japan the 4<sup>th</sup> largest donor in the world and highest in Asia.

The table given below shows the quantitative picture of how the net official development has expanded from 1987 to 1994,



Year	Net resource outflow
1987	85.8
1988	98.3
1989	116.0
1990	126.3
1991	122.3
1992	147.8
1993	155.9
1994	213.5

**Source:** DAC press release 1996.

Japan's growth in providing the assistance to different countries during 1965 was too low when compared to the outflow of 1990 it showed a dramatic increase in the country's assistance to other countries and this made Japan one of the finest and largest donor of the world

Even though the country started providing substantial foreign assistance to other developing countries the GDP has tremendously increased ,but it is seen that the GDP has seen a constant increase of negative impact that is, in the same period where the GPD growth rate declined from 8.4% to 2.1%.

- *India*

India is a rapidly growing country with a population of 1.35 billion and is the sixth largest economy in the world by GDP (nominal). Its economy grew by an average of 6-8% a year after the liberalization policies in 1991..It is expected to be one of the top three economic powers in the span of next 10-15 years. In recent times it has been emerging out to be a significant donor for developing countries, especially for its neighboring countries. There has been a significant improvement in economic performance in terms of GDP and quality of life, the reduction in poverty is also one of the fastest in the world, but the concern lies to know if India really is capable of becoming a significant donor considering the fact that nearly 23.6% of Indian population lives below \$1.25 per day. (**Poverty in India**)

- Analysis and interpretation

We have analyzed the economic variables and identified the relationship between the same as given below. It is to be noted that only foreign aid received between 1996 to 2000 and aid given between 2011 to 2015 are taken into consideration.



Objective 1:

**H<sub>0</sub>:** There is no relationship between foreign aid given and economic indicators.

**H<sub>1</sub>:** There is a relationship between foreign aid given and economic indicators

From the analysis		<b>GDP growth</b>	<b>HDI</b>	<b>Export</b>
	<b>FOREIGN AID GIVEN</b>	Significance level .439	.062	.436

ysis of the economic variables using Pearson's correlation we can see that the significance of all the economic variables is above 0.05, hence we accept the null hypothesis and reject the alternative hypothesis .Therefore it is understood that there exists no relationship between the foreign aid given and the economic variables.

Objective 2:

**H<sub>0</sub>:** There is no relationship between foreign aid received and economic indicators.

**H<sub>1</sub>:** There is a relationship between foreign aid received and economic indicators.

		<b>GDP growth</b>	<b>HDI</b>	<b>Export</b>
	<b>FOREIGN AID RECEIVED</b>	Significance level .560	.010	.221

From the analysis of the economic variables using Pearson's correlation we can see that the significance of variables "GDP growth" and "Export" are above 0.05 and that of variable "HDI" is below 0.05.Hence we accept null hypothesis for "GDP Growth" and "Export"

On the other hand we reject null hypothesis and accept alternative hypothesis for "HDI" as the significance level fall short 0.05. Therefore, there exist a relationship between foreign aid received and human development index.

**X. Findings and Suggestions**

The aim of this research paper is to study how inflow and outflow of foreign aid affects various economic variables like GDP, HDI, exports etc. Pearson correlation formula is applied to study these variables. After the analysis it has been observed that there is no significant relationship between these economic indicators and receipts/payments of foreign aid. India's change from recipient to donor of foreign aid has however benefited the country in many ways. It has helped India to develop a favorable relationship with other

countries. The results suggest that payment of foreign aid by India has not affected the country in terms of its GDP, HDI and Exports. But we have found that the Human Development Index had a positive relationship with the foreign aid received, while the GDP and Exports stayed unaffected. This is because the foreign aid that was received by India was effectively channelized for the purpose of development despite being manipulated under layers of bureaucracy. The study signifies that India can confidently continue with its aid assistance program which in long term can be an added advantage to its market expansion.

## **XI. Conclusion**

India is the largest democracy in the world. It accommodates almost 17.74% of the total world population and is a prominent player in economic development map of the world. Whilst, India is also known for its vast poverty level, corruption and mal-governance. This explains that India is still has a lot more to improve in various fields in order to overshadow other countries. Despite these concerns it is quite puzzling that India has developed into an aid donor, gradually transforming itself from an aid recipient. This paper is intended to justify India's transformation from an aid recipient to a donor. We have analyzed India's aid inflow and outflow with its GDP, HDI and exports it has generated in the corresponding year. It is evident that India has not forgone its economy while entering into development assistance of other countries. Even though at times the marginal growth rate has slightly declined, the increasing aid assistance has improved India's external relationships. We also have conducted a case study to examine whether India is different from other countries which in similar has transformed from an aid recipient to a donor. Aftermath the analysis it is observed that no nations have forgone their countries interest for the transformation rather this change in status has benefited them in multiple ways.

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