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Effect of Foreign Aid on Welfare in the ECOWAS region

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Abstract
West Africa had been faced with a series of challenges such as droughts, famine, and armed violence that had resulted in the displacement of the people with adverse consequences on economic growth, and welfare. These challenges had led to foreign aid inflow in the form of official development assistance (ODA). This study used panel data for the period 1997 to 2020 and was analyzed using difference generalized method of moment (DIFF GMM). It was found that foreign aid had positive effect that was statistically significant on welfare (measured as per capita income) in Francophone and landlocked countries of West Africa but statistically insignificant for the whole region. The study recommends the setting up of a regional aid policy that will serve as a convergence criterion to ensure improvement in welfare.

Key Words: Welfare, Foreign aid, Land-locked, Coastal, Economic Growth.

JEL: *E20, F40, F35, D60*

1 Introduction

Modern African states at independence from their colonial masters had little or no infrastructure in place that will guarantee sustainable growth and development. This therefore made the development of soft and hard infrastructure a necessity for these states. In order to achieve this, African countries were granted foreign aid, loans and technical support from multilateral financial institutions and advanced economies of the world (Kalu, 2018). Due to the spate of developmental challenges and widespread poverty, Africa has been one of the major beneficiaries of foreign aid. Between 1960 and 2013 sub-Sahara Africa had received an estimated 848.4 billion USD as official development assistance (ODA) besides bilateral support from several private donors (Kalu, 2018).

The spate of democratization and violence in some Economic Community of West Africa States (ECOWAS) member nations had contributed to a rise in the use of foreign aid to

support and also cushion the various effects of crisis. In Nigeria, there has been the Boko Haram insurgency alongside various militia attacks which had displaced thousands of citizens, internally. In Mali, there has been violence in the northern part of the country that had displaced several citizens and led to the dead of many. Sierra Leone had experienced a landslide and had its share of violent conflicts that had led to the destruction of lives and properties, while countries like Chad, Niger are faced with the threat of famine due to poor rainfall and desertification. The Ebola virus had also brought havoc in the region, and had pushed families into poverty, death and loss of skilled manpower in the region with adverse effects on economic growth and welfare. Also, the region, just like other parts of the world, had been experiencing climatic changes that had threatened the livelihood of several citizens. All of these had contributed to the inflow of foreign aid from international organizations through various governmental and non-governmental agencies with the goal of improving the welfare of citizens in the region because aid, according to Rajan and Subramanian (2008) can contribute to a country's development by taking a capital starved country to its ultimate steady potential growth rate faster and can also improve a country's ultimate steady state growth rate

According to Summer and Glennie (2015) total official development assistance (ODA) to Africa as at 2015 was $138.5 billion per year which accounts for overwhelming majority of foreign aid. According to Niyonkuru (2016) foreign aid was given for developmental projects, supplement budgets, disaster and debt relief with a view to ending poverty and attainment of millennium development goals. Kalu (2018) stated that Africa has received more aid than any continent in the World and it has been helpful as a palliative, especially in the health sector where there had been several interventions with regards to preventable diseases that would have ravaged some communities. Despite these, African countries are still poor and backwards and the continent's developmental challenges still persistent. This according to Moyo (2009), is because aid has continued to be, for the most part of the developing world, an unmitigated political, economic and humanitarian disaster, which is the root of Africa's inability to join the rest of the world in advancement.

The effect of foreign aid had been controversial, pitching analyst, academics and practitioners into various camps due to different findings in literature (Tarp, 2006). This is because both positive and negative effects were found. According to Juselius, Moller and Tarp (2014) the choices made by researchers regarding data transformations, econometric models, estimation techniques, and assumptions related to endogeneity or exogeneity are some of the reasons for discrepancies in findings. On why foreign aid had not been effective, Das, Mourmouras and Rangazas (2018) stated that the correlation between growth and foreign aid inflows into a poor country had been, at best, weak. While Brautigam (2009) sees the motive for foreign aid by donors and the conditionalities as responsible for its negative outcome because China's foreign aid had been given with business interests that are meant to grow (Chinese) businesses and grow their exports while traditional donors (Europeans and Americans) give aid with conditionalities which could be governance or economic reforms or both. The traditional donor projects are not based on the presented needs of recipient countries but that of the donor. Furuoka (2017) stated that foreign aid given to African countries was driven by the self-interest of the donors, not the recipient countries. According to Dalgaard, Hansen, and Tarp (2004), the controversy in literature about the effectiveness of foreign aid from data shows that, foreign aid is far from being equally effective everywhere.

The analysis of foreign aid in the literature treats countries as a homogeneous group, while others gave attention to regional groupings at the continental level without attention to the heterogeneity within the sub regional units (Adedokun, 2017; Nowak-Lehman et al., 2012; Nwaogu and Ryan, 2015) while (Burnside and Dollar, 2000; Bjerg, Bjornskov, and Holm, 2010) focused on the internal macro-economic policy environment of recipient countries as having an important role for foreign aid effectiveness. According to Kalu (2018) the African continent is made up of 54 countries that are different in-terms of their systems of government, cultures, histories and economic arrangement. This also applies to the sub-regions of the continent as well.

The ECOWAS region is not homogeneous as such, there is the need to consider possible heterogeneity and how it may influence the effect of foreign aid on welfare. Countries in the region had different colonial experiences that had influenced their style of governance and linguistic interactions. Portuguese, English and French, colonized countries in the region and allegiance to the colonial masters continued even after the official end of colonialism. The use of the francs as currency and medium of exchange by French speaking countries is a factor that ensures some homogeneity among the countries besides the common inherited governance system. In English speaking countries, a common governance system based on the indirect rule system guided by the British jurisprudence was inherited. Also, these countries are members of the common wealth of nations where some common policies and programs are implemented that affects the welfare of citizens and the behavior of economic variables in the member states. Moreover, for several decades, colonial masters had been the major trading partners of their former colonies.

Within the study period, the major donors of foreign aid to the region were France, United Kingdom, the International Development Association (IDA), Portugal and the United States of America and their assistance was basically targeted at former colonies. The macroeconomic policies pursued by each country, the nature and quality of governance, the strength of institutions, the country's level of income, the amount of aid given, sector(s) where it was channeled are all crucial in determining the effect of aid. One other basis of heterogeneity within the sub-region is the geographical nature of member countries, where some are landlocked and others coastal. The cost of doing business and the behavior of economic variables in these countries may vary due to their geographical and topographical nature and proximity to the sea. According to United Nations Economic Commission for Africa[UNECA] (2015) landlocked countries are more dependent on agriculture than coastal countries and may face challenges in developing industry because of disproportionately high trade and transaction cost, poor access to ports and a low manufacturing sector contribution of -36 percent between 2000 and 2012 to industrial growth. Literature had not given attention to the common colonial heritage and the geographical uniqueness of countries and how the countries are affected by foreign aid. The effect of aid on growth had been extensively explored in literature, while its effect on welfare especially in West Africa had not been explored with regards to geographical and colonial heterogeneity of recipient countries. This paper fills this gap. The aim of this paper is to find out how foreign aid affects the welfare of citizens in West Africa, French (francophone) and English-speaking countries, Coastal and Landlocked countries in West Africa sub-region. The paper is structured into five sections of introduction and review of literature in sections one and two while sections three and four are the

methodology and discussion of result and findings and section five provides conclusions and recommendations respectively.

2.0. Empirical Literature Review.

There had been studies on various aspects of welfare with the focus primarily on economic growth as it trickles down to the citizens.

Burnside and Dollar (2000) studied the effectiveness of aid within the context of a country's macroeconomic environment to determine if the macroeconomic policies contribute to the effectiveness or not of foreign aid in an economy. The paper used a panel of 56 countries for the period 1970 to 1993 in six four-year term periods. Foreign aid had a positive effect on growth in developing countries with good monetary, fiscal and trade policies but little impact in the presence of poor policies. Juselius, Moller, and Tarp (2014) used the cointegrated vector autoregression model and found that in the long run, foreign aid flows had a positive effect on the macroeconomy of 36 African countries based on a data from the mid-1960s to 2007. Bjerg, Bjornskov, and Holm (2010) found that in 38 least developing countries, aid was not generally associated with growth, but had an alleviating effect when interacted with external debt. The study used a barro-type regression and fixed effects was found to be the most suitable based on the Hausman test. Thus, giving emphasis to the macroeconomic economic environment as an important determinant of foreign aid effect.

Arndt, Jones, and Tarp (2015) sought to find out if foreign aid had any effect on human resources and welfare of citizens in recipient countries. The study found that aid had a positive impact on human and physical capital, indicators of social welfare (poverty and infant mortality) and measures of economic transformation which are proximate sources of growth. The study found that for forty years, aid stimulated growth, promoted structural change, improved social indicators and reduce poverty. Adedokun (2017) sought to find out if foreign aid works or affects growth the same way in all regions in sub-Sahara Africa and if the size of governance and aid matters. Forty-seven sub-Saharan African countries were studied for the period 1996 to 2012 and a system generalized method of moment was used. The study found that heterogeneity had implications for aid effectiveness in sub-Sahara Africa. An insignificant negative effect of foreign aid on economic growth in sub-Sahara and Western region of Africa was found.

The effect of foreign aid on per-capita income by Nowak-Lehman et al., (2012) on fifty countries with balanced, and one hundred and thirty-one with an unbalanced panel data based on a five-year average cycle. The study found that foreign aid had an insignificant effect on per-capita income for countries with above average aid-to-GDP ratios and different levels of human development and income. The result for highly aid-dependent countries showed that foreign aid had a minute, negative and statistically significant effect on per-capita income. A related paper on per-capita income that used a panel vector autoregression model, Lof, Mekasha, and Tarp (2015) found that aid had a positive and statistically significant long-run effect on income. A one percent increase in aid receipt was estimated to raise income per capita by 0.17 percent over a 10-year period. Dalgaard, Hansen, and Tarp (2004) re-examined the theoretical and empirical effectiveness of foreign aid based on overlapping generations model (OLG) and found that in the long run foreign aid will generally affect productivity and it has been useful in spurring growth with the magnitude, dependent on climate related circumstances. In tropical areas, aid seems to have been less effective in over three decades.

This result is affected by the size of the inflow of aid, and policies deep structural characteristics.

Rajan and Subramanian (2008) presented in one place, using one framework the different aspects of aid-growth relationship. To achieve this, they examined the possibility of aid having more effect on growth, based on the policy environment and the institutional framework, geographical location and the form of aid. The study used a cross-sectional, panel data and found no robust, positive or negative effect of aid inflows into countries on economic growth irrespective of the presence or absence of outliers. The policy environment and location of the country also had no robust positive or negative effect on growth which was contrary to the findings of Burnside and Dollar (2000) with regards to the role of policy environment, aid and growth, and also Dalgaard, Hansen, and Tarp (2004) with regards to the geographical location of the recipient country. On different forms of aid, it was found that there was no better performance between the different forms of aid. It was therefore difficult to determine any systematic effect of aid on growth.

Nwaogu and Ryan (2015) found in a study of fifty-three African countries and thirty-four Latin American and Caribbean countries, based on the dynamic spatial framework, found in separate estimation that foreign aid affects growth in African, Latin American and Caribbean countries.

Mba, Bell-Gam, and Ubi (2012) found, using seemingly unrelated regression estimation (SURE), that ODA had a positive impact on the economic growth of Nigeria. Also, Babalola, Mohd, Ehigiamusoe, and Onikola (2019) found that foreign aid had a positive long-run effect and short -run impact on economic growth in Nigeria. This was due to the nation's transition to civil rule and its effect on the economy was through, improvement in the stock of physical, human and institutional capital, job creation and better competitiveness and knowledge transfers.

The review of literature showed that there had been conflicting findings with regards to the effect of foreign aid on economic growth. The negative effect of foreign aid has led to calls for its rejection because of the political nature of aid and some conditionalities attached which are not necessarily favorable, especially for Africa.

3.0. Methodology

This paper is based on the neoclassical growth model that was developed by Solow-Swan 1956. The model posits that output is a function of labor, capital and technology. The Solow model is stated thus;

$$Y_{it} = A_{it}K_{it}^{\alpha}L_{it}^{1-\alpha}$$

(1) Where $A_{it}K_{it}L_{it}$ are technology, capital and labor in country i at time t and converted to logarithm thus;

$$y_{it} = a_{it} + \alpha k_{it} + (1-\alpha)l_{it} \qquad (2)$$

The specification of the model was done following Adedokun (2017) as follows;

$$y_{it} = a_{it} + \beta_i x_{it} + \gamma_i z_{it} + \varepsilon_{it} \qquad (3)$$

Based on a dynamic panel data, the model was further specified thus;

$$y_{it} = a_{it} + \partial y_{it-1} + \beta_i x_{it} + \gamma_i z_{it} + \varepsilon_{it} \quad (4)$$

and is transformed into a difference model thus;

$$\Delta y_{it} = a_{it} + \partial \Delta y_{it-1} + \beta_i \Delta x_{it} + \gamma_i \Delta z_{it} + \Delta \varepsilon_{it} \quad (5)$$

Where y_{it} is GDP per capita income annual percentage growth as proxy for welfare in country i at time t and y_{it-1} is the lag of GDP per capita income for country *i* in time *t*, x_{it} is the variable of interest which is foreign aid and it's proxy is net ODA received for country *i* in time *t* measured as percentage of gross national income; z_{it} captures other variables used in the model such as exports of goods and services measured as percentage of gross domestic product. External debt is the external debt stock as percentage of gross national income, foreign direct investment net inflow as percentage of gross domestic product, labor productivity as GDP per person employed in US dollars (2017 PPP) and population in numbers as proxy for labor. These variables capture the possible effects of both external and domestic influences on the per capita income (welfare) of citizens in the region. Data for the study period (1997 to 2020) was sourced from World Bank's World Development Indicators (WDI) 2022, African Development Bank's Africa statistical year-book 2019 and 2020.

4.0 Discussion of Result and Findings.

Difference Generalized Method of Moment (DIFFGMM) by Arrenalo-Bond was used for the study. This was because the model is suitable for analysis where the time dimension is greater than the cross-sectional dimension. It was also used because of the model's capacity to handle possible endogeneity problems because economies that are faced with catastrophes usually get more foreign aid or those that are experiencing growth and are adjudged to have better macro-economic management policies get more external funding in the form of foreign aid. One or both situations could lead to possible endogeneity that may result in biased findings. The model is efficient and robust to heteroscedasticity and autocorrelation problems especially with the use of robust standard errors. Correlation coefficient and variance inflation factor (VIF) results are presented in the Appendices A2 and A3 respectively. The model estimated results are presented in Table 1

Table 1: Empirical Result for the Effect of ODA on Per Capita Income

Variables	ECOWAS	Francophone	English speaking	Land- locked	Coastal
Lag GDP Per capita	0.0080 (0.7834)	0.0024 (0.0962)	-0.0313 (0.0706)	-0.2934*** (0.0176)	0.0351 (0.0910)
Foreign Aid (Net ODA)	-0.0336 (0.1184)	0.1838** (0.5878)	-0.0110 (0.0558)	0.2905*** (0.0582)	-0.0601 (0.1213)
Exports	0.1143** (0.5054)	0.0034 (0.0448)	0.1227*** (0.0103)	-0.1117 (0.0890)	0.1222** (0.0441)
External debt	-0.027*** (0.0076)	-0.0341 (0.0230)	-0.0289*** (0.0065)	0.0363 (0.0339)	-0.025** (0.0092)
FDI	0.1284** (0.0622)	0.1586 (0.0989)	0.1266*** (0.0197)	0.3987*** (0.0742)	0.1353** (0.0641)
Population	-7.3035** (3.6275)	-3.7482 (3.2589)	-7.0312 (5.9992)	-2.8627 (2.8233)	-4.8459 (5.3881)

Labor productivity	6.1711 (2.8158)	7.7808* (4.2817)	1.751 (3.0239)	9.3184* (5.4850)	3.0008 (3.6242)

Note: ***, **, * signifies significance at 1, 5 and 10 percent respectively. Parenthesis are robust standard errors. Liberia was not included because of data problems. The result of Portuguese countries is in appendix A1 because of the small sample size.

The result from table 1 show that foreign aid (Net official development assistance [ODA]) was found to be statistically insignificant for the ECOWAS sub-region and the coefficient was negative. This was similar to the findings of Adedokun (2017) for west Africa. It was the same for coastal and English-speaking countries while in landlocked and Francophone countries foreign aid had a positive effect on welfare and the coefficient was statistically significant. The finding for the whole region, English-speaking and coastal countries was in-line with the findings of the fourth-generation literature on foreign aid which showed that aid may be ineffective in spurring growth and by implication the per capita income of citizens (Arndt, Jones, & Tarp, 2010). According to Nowak-Lehman et al., (2012) the insignificant effect of aid according to literature could be because of weak institutions, corruption, appreciation of the real exchange rate in recipient countries, the motivation of the donor country, the type of aid given and the sector(s). Kalu (2018) stated that foreign aid cannot eradicate poverty in Africa because the financial gap that foreign aid seeks to fill, is a consequence of poverty and not the cause. Also, the nature of the African state and its political and economic institutions which are extractive, are largely not developmental nor inclusive which contributes to aid's ineffectiveness. These provide incentives for agents that facilitate choices which destroy instead of promote society's welfare as such, the transfer of cash and other materials in the form of foreign aid would not change the level of poverty among the people.

In land-locked and Francophone countries, foreign aid had a positive effect on welfare and the coefficient was statistically significant. This could be due to the use of local skilled labor and material resources for the execution of aid related projects and also because governments in Africa ensure a spill over of such aids (from China) to their nationals by the use of various percentages and ratios for the employment of nationals and foreigners on aid funded projects (Brautigam, 2009). Burnside and Dollar (2000), Arndt, Jones, and Tarp (2015) all found that aid had a positive effect on growth. Nwaogu and Ryan (2015) also found that foreign aid impact growth positively in African countries and negatively in Latin American and Caribbean countries. While Rahnama, Fawaz, and Kaj (2017) found a negative effect of foreign aid on low-income developing countries and a positive effect on high income developing countries. Brautigam and Knack (2004) found an adverse effect on the quality of governance (which affects the welfare of citizens) in sub-Sahara Africa by higher foreign aid because it creates dependence, fragmentation and high transaction cost, competition by donor nations for scarce skilled manpower and the inability of government to effectively manage and monitor the myriad of projects by donor nations. Donor interest in determining policy and the imposition of technical assistance, result in neutral or adverse foreign aid effects.

Exports had a positive effect on per capita income (welfare) in the region and the coefficient was statistically significant. This finding was the same in English speaking and coastal member states, but not in Francophone and landlocked countries. This implied that

goods and services exported from the region, contributed to the improvement of welfare in ECOWAS member states in English-speaking and coastal countries. This is because countries close to the coast have lower cost of transportation due to their proximity to the coast compared to landlocked countries.

External debt had a negative effect on welfare for the whole region and the coefficient was statistically significant. This implied that external debt in the region had not been channeled into activities that had led to the improvement of per capita income, or the welfare of citizens in the region. It also had a negative effect on the welfare of citizens in coastal and English-speaking nations with a statistically significant coefficient. This finding could be as a result of ineffective utilization of loans. A similar finding was made in Tunisia, where external public debt had a growth damaging effect in the economy with a higher long-run deleterious effect on per capita GDP (Mohamed, 2013). Augustin (1999) also found a deleterious effect on economic growth for given levels of production inputs of 35 sub-Saharan African countries while Guei (2019) found no robust long run effect of debt on economic growth of 13 emerging countries. Contrary finding was made by Siti, Abd, and Azman-Saini (2013) who found that, to a certain threshold, external debt had a positive effect on economic growth in Malaysia. In Landlocked and French speaking countries of the region, external debt had a positive sign but statistically insignificant coefficients. This could be as a result of the top-down policy and project approach of most governments in Africa, which had led to disconnection with the people, and the utilization of loans in areas that have little or no impact on the welfare of citizens.

For all ECOWAS member countries, population had a negative effect on welfare with a statistically significant coefficient. This conforms with the apriori expectation of the study. The more the population of a country increases and there is no corresponding increase in production, job creation and income, welfare will be adversely affected. It is also in-line with the predictions of Thomas Malthus on population growth and food supply. Where Malthus stated that population increases at geometric rate while food supply increases at arithmetic rate. Africa still lags behind other continents of the world in-terms of the production of goods and services, and the technological innovation that facilitates such output and welfare improvements. According to FAO,ECA and AUC (2021) the number of undernourished people in Africa was about 200 million which was due to rapid population growth. As a result, the number of hungry people in Africa was 250.4 million in 2019, an increase of 47.9 million since 2014 which accounted for the bulk of the 58.9 million global increases in the undernourished. Sub-Sahara Africa is home to 234.7 million while north Africa housed 15.6 million of these hungry people and is due to conflicts, weather changes, economic slowdowns and downtowns that were often overlapping. This finding is different from Adedokun (2017) that found a negative and statistically insignificant effect on growth in Sub-Sahara Africa but a positive and statistically insignificant effect on West Africa. Classification of the countries based on their colonial experience and geographical nature showed that the population had a negative sign but statistically insignificant coefficient in Francophone, English-speaking, landlocked and coastal countries. The negative sign suggests the population growth in West Africa has not been channeled into productive use due to possible poor skills, low productivity of factors of production and conflicts in the region that had led to displacement of citizens.

5.0. Conclusion and Recommendations

West Africa has been embroiled in a series of conflicts that are largely internal coupled with natural disasters that has necessitated the inflow of foreign aid in the form of official development assistance. The use of foreign aid and its welfare effects especially on economic growth has been controversial. This is because of the positive and negative effects of foreign aid which had been attributed to moral hazard and other negative effects and had led to calls for its rejection in some quarters. This paper found within a panel framework that foreign aid (ODA) had a negative but statistically insignificant effect on per capita income for the region, a positive effect that is statistically significant for francophone and land-locked countries, and statistically insignificant coefficients in English-speaking and coastal countries.

There should be a regional policy with minimum benchmarks and priority sectors for the use of foreign aid which should be like the convergence criteria that was set up for taxes and monetary policy. It should be done without infringing on the uniqueness of member states, so that it will continue to benefit the citizens of the region.

Exports should be improved upon by working on the value chain of the products exported. This will generate additional employment opportunities and income for the citizens thereby improving on welfare in the region.

There should be concerted effort by the people with the support of foreign partners to ensure that the African system of governance and its institutions are transformed into developmental systems and made more effective in-terms of governance.

Aid should be focused on domestic industrial production of goods and services in recipient countries and not importation of products as aid. This will facilitate domestic production and exports in recipient countries.

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APPENDICES

Table A. 1 Result of Portuguese Countries.

Variables	**PORTUGUESE**
Lag GDP Per capita	-0.2516***
	(0.8940)
Foreign Aid (Net ODA)	-0.2849***
	(0.3490)
Exports	0.3656***
	(0.1209)
External debt	-0.0573***
	(0.0061)
FDI	0.6013***
	(0.0343)
Population	-38.5085***
	(2.8670)
Labor productivity	-17.7258***
	(1.8165)

Note: ***,**,* signifies significance at 1, 5 and 10 percent respectively. Result in parenthesis are robust standard errors.

Table A. 2 Pairwise Correlation

	GDP Per Capita	Net ODA	Exports	External Debt	FDI	Population	Labor Productivity
GDP Per capita	1.0000						
Net ODA	-0.1044	1.0000					
Exports	0.1431	-0.1893	1.0000				
External Debt	-0.3041	0.5727	0.0188	1.0000			
FDI	0.2079	0.0966	0.2335	-0.1089	1.0000		
Population	0.0297	-0.5148	-0.1238	-0.3631	-0.2295	1.0000	
Labor Productivity	0.1771	-0.3169	0.2587	-0.1544	0.1125	-0.0353	1.0000

Table A 3. Variance Inflation Factor

Variables	**VIF**	**1/VIF**
Net ODA	2.25	0.444512
External Debt	1.65	0.606624
Population	1.57	0.638542
Exports	1.24	0.807941
Labor Productivity	1.22	0.819853
FDI	1.20	0.834558
Mean VIF	1.52	