WORLD FINANCIAL AIDS AND SOCIO-ECONOMIC DEVELOPMENT: 
THE CHALLENGE OF POVERTY ALLEVIATION IN NIGERIA

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Abstract
This paper analyzes the effects of foreign aid on the economic growth of developing countries. The specific objectives were to examine the roles of world financial assistance in reducing poverty; Assess the level of world Bank operation in the nation building through poverty alleviation; and to make recommendation for effective and efficient realization of world financial scheme. The study adopted historical and descriptive analytical method. The results obtained from studies for a sample of developing countries suggest that the poor benefit from the world financial aid by the ability of the banking system to facilitate transactions and provide savings opportunities but to some extent fail to reap the benefit from greater availability of credit. Moreover, it was also discovered that financial development is accompanied by financial instability, which is detrimental to the poor. Nevertheless, the benefits of financial development for the poor outweigh the cost. The study therefore recommends that the commitment of the recipient countries to reform their institutional structures and policies is a necessary condition for aid to be effective, that without political will at the top level, reforming governance may be very challenging. Again, the donors’ country should give the recipient countries an incentive to be less reliant on aids and donors technical assistance. This is believed would reduce poverty and boosts the economy of the recipient countries.

Key words: World financial aid,, Socio-economic development, poverty alleviation.

I. Introduction
The tradition of giving foreign aid to developing or aid-needing country began after World War II. Initially aid was given to the war-devastated countries to rebuild the economies. Then in the early 1950s, the United States and the Soviet Union began distributing aid to strengthen the military capability of their allies and spread their political ideologies. Since the end of the Cold War, in 1989, most aid has been targeted to promote economic growth and improve public well-being in the developing and underdeveloped countries (Foreign Aid, 2008). More aid is now channeled through international financial institutions (IFIs) such as IMF, World Bank, and OECD. During the 1990s, the goal of aid was to foster democratization and stability in developing countries and to facilitate the transition to free market economies in former communist countries.
Since the late 1990s, foreign aid has been given to developing countries to promote economic growth, encourage the development of democratic institutions, and provide for humanitarian needs. Further, the end of the cold war also led to the shift of some aid from bilateral to multilateral aid. In addition, after the 9/11 attack, the United States began giving huge amounts of bilateral aid to countries cooperating with its fight on terrorism. Billions of US dollars have gone to newly allied countries such as Pakistan, Afghanistan and Iraq. For instance, since September 2001 Pakistan has received about USD 8 billion for cooperating in a fight against terrorism and about USD 3 billion for economic and development assistance (CAP, 2009). This aid is usually given without the consideration of recipient countries’ governance quality, ideology, and economic conditions, as they agree to cooperate with the US in the fight against terrorism—e.g., by allowing the United States to use their country as a base to gather intelligence.

In 2002, President George W Bush announced a USD 5 billion increase in foreign aid (Easterly, 2005). In 2004, the United States also created the Millennium Challenge Corporation (MCC) to distribute aid to countries with good economic policies and governance aiming to promote economic growth. Recently, the debate on whether bilateral and multilateral aid, should be given to developing countries to foster economic growth and provide for humanitarian needs has been resurrected. Bill Gates, the president of Bill and Melinda Gates Foundation, argues that aid is an effective way for lifting the poor out of poverty. And he believes that free market economy alone is not sufficient to help the poor. In contrast, Easterly William, a leading scholar in economic development, argues that free market capitalism would help eliminate the world poverty. He believes “the poor suffer because of too little capitalism” (Easterly, 2008). Similarly, while aid is expected to promote economic growth, some policymakers also believe that aid given to corrupt government fosters corruption rather than increase economic growth.

Statement of the problem

Today, an important objective of aid is to promote the economic development and welfare of recipient countries; it is usually measured by its impact on economic growth. In recent years, economists and policy makers have debated whether aid has any positive effect on economic growth. The late Milton Friedman and development economist like Peter Bauer, for example have argued that aid does not have positive impact on economic growth, and in some cases it might even ruin the countries that aid is given to. According to Bauer, “Development aid is ... not necessary to rescue poor societies from a vicious circle of poverty. Indeed it is far more likely to keep them in that state. It promotes dependence on others. It encourages the idea that emergence from poverty depends on external donations rather than on people’s own efforts, motivation, arrangements and institutions” (Bauer, 1976). In contrast, other scholars believe that aid would be effective in promoting growth if certain criteria are met. Jeffrey Sachs for example, believes that developing countries need aid to initiate economic growth, and once the economic growth takes place the country will be able to sustain itself. Without aid, some developing countries would be stuck in what he calls the "poverty trap" forever. He asks donor countries to increase aid to the poor countries. Sachs concludes that “When countries get their foot on the ladder of development, they are generally able to continue the upward climb.... If a country is trapped below the ladder, with the first rung too high off the ground, the climb does not even get started. The main objective of economic development for the poorest countries is to help these countries get a foothold on the ladder. The rich countries……need to invest enough so that these countries can get their foot on the ladder. After that, the tremendous dynamism of self-sustaining economic growth can take hold’’
(Sachs, 2005). Similarly, James Wolfensohn, the former World Bank President, argues that aid would be effective if the recipient countries could restraint corruption, improve their policies and governance capacity (Easterly, 2003).

Every year, on average, IFIs and developed countries around the globe give about USD 70 billion in aid to developing and poor countries (OECD, 2009). In 2007, such aid totaled USD104 billion. Since the late 1980, much of the aid from multilateral agencies has been linked explicitly to macroeconomic policy reforms and structural adjustments. Most bilateral aid has also become conditional on the recipient countries improving their governance quality.

Nevertheless, the effect of this aid is in doubt. Kasper (2006) argues that over the past 50 years USD 1 trillion given to sub-Saharan African countries has not produced any significant impact on economic growth. In addition, it is found that corruption has hindered economic growth of most aid-recipient countries in African countries (Kasper, 2006). Despite receiving foreign aid for promoting economic programs over the past decades, some countries have experienced a decline in their real GPD per capita in comparison to a few decades earlier. For example, Zambia’s average income fell from USD 540 to USD 300 between 1964 and 2000, despite getting more aid per capita than any other countries (Werlin, 2005).

In addition, a UN study in 1994 found that income in some aid recipient countries had actually fallen. This study therefore seeks to look at the impact of foreign aids on socio-economic development of the third world countries, especially Nigeria.

Objectives of the study
The specific objectives are to:
(i) Examine the roles of world financial assistance in reducing poverty;
(ii) Assess the level of world Bank operation in the nation building through poverty alleviation;
(iii) To make recommendation for effective and efficient realization of the scheme.

Research Questions
In order to achieve the above stated objectives, the following research questions are advanced:
(i) Does world financial aid significantly contribute to poverty reduction and improved standard of living of people in Nigeria?
(ii) Do poor have access to world finance funds and loans for the development of micro enterprises in Nigeria as expected?
(iii) What are the prospects of world financial aid in the reduction of poverty in Nigeria?

Formulation of Hypothesis
The following null hypotheses are proposed and tested in the course of this study.
(i) There is no significance difference between countries who receive financial assistance from world financial institutions and those who do not.
(ii) There is no significant effect of world financial activities on poverty alleviation in the country, Nigeria.
(iii) There is no significant effect of world financial activities on sustainable development.
Literature Review
The relationship between foreign aid and economic growth has drawn great attention for years, but the empirical results are mixed. There is now a large literature on the relationship between aid and growth.

McGillivray (2005) conducted a study to demonstrate how aid to African countries not only increases growth but also reduces poverty. Furthermore, the author points out the important fact that continuously growing poverty, mainly in sub-Saharan African countries, compromises the MDGs (Millennium Development Goals) main target of dropping the percentage of people living in extreme poverty to half the 1990 level by 2015. His research econometrically analyzes empirical, time series data for 1968-1999. The paper concludes that the policy regimes of each country, such as inflation and trade openness, influence the amounts of aid received.

Ouattara (2006) analyzes the effects of aid flows on key fiscal aggregates in Senegal. The paper utilizes data over the period of 1970 – 2000 and primarily focuses on the interaction between aid and debt. The author determined three main outcomes of his study. First, that a large portion of aid flows, approximately 41%, are used to finance Senegal’s debt and 20% of the government’s resources are devoted to debt servicing. Second, that the impact of aid flows on domestic expenditures is statistically insignificant, and third that debt servicing has a significant negative effect on domestic expenditure. As a result, his paper suggests that debt reduction could become a more successful policy tool than obtaining additional loans.

Addison, Mavrotas and McGillivray (2005) examine trends in official aid to Africa over the period 1960 to 2002. The authors largely emphasize the tremendous decrease in aid over the last decade which will have an impact on Africans living in poverty and the African economy as a whole. As a result of the shortfall in aid, the MDGs will be much harder if not impossible to be achieved. The paper concludes that aid in fact does promote growth and reduces poverty. Furthermore, it also positively impacts public sector aggregates, contributing to higher public spending and to lower domestic borrowing. Nevertheless, it is apparent that the MDGs cannot be achieved with development aid alone, but other innovative sources of development finance need to be explored as well.

A study by Karras (2006) investigates the correlation between foreign aid and growth in per capita GDP using annual data from the 1960 to 1997 for a sample of 71 aid-receiving developing countries. The paper concludes that the effect of foreign aid on economic growth is positive, permanent, and statistically significant. More specifically, a permanent increase in foreign aid by $20 per person results in a permanent increase in the growth rate of real GDP per capita by 0.16 percent. These results are obtained without considering the effects of policies.

Gomanee, Girma, and Morrissay (2005) address directly the mechanisms via which aid impacts growth. Using a sample of 25 Sub-Saharan African countries over the period 1970 to 1997, the authors determined that foreign aid has a significant positive effect on economic growth. Furthermore, they identified investment as the most significant transmission mechanism. The paper concludes that on average, each one percentage point increase in the aid/GNP ratio contributes one-quarter of one percentage point to the growth rate. As a result, Africa’s poor growth record needs to be attributed to factors other than aid ineffectiveness.

Quartey’s, (2005) in his research focuses on innovative ways of making financial aid effective in Ghana. The author concluded that mainly MDBS (multi-donor budgetary support) could be successful, but only if the government of Ghana and its partners plan better and coordinate their efforts. Moreover, the government needs to work on reducing its debt burden, so it would not use its aid inflows to service its debt. The author suggests that the MDBS cannot be fully successful
until it is entirely synchronized with other forms of project aid and until the inflows become more predictable.

In his research, Ram (2004) looks at the issue of poverty and economic growth from the view of recipient country’s policies as being the key role in the effectiveness of foreign aid. Nevertheless, in his paper the author disagrees with the widely-acknowledged view that redirecting aid toward countries with better policies leads to higher economic growth and poverty reduction rates. As a result, based on his research the author concludes that evidence is lacking to support the leading belief that directing foreign assistance to countries with good ‘policy’ will increase the impact on growth or poverty reduction in developing countries.

Role of world financial aid and socio-economic development
The main role of foreign aid in stimulating economic growth is to supplement domestic sources of finance such as savings, thus increasing the amount of investment and capital stock. As Morrissey (2001) points out, there are a number of mechanisms through which aid can contribute to economic growth, including (a) aid increases investment, in physical and human capital; (b) aid increases the capacity to import capital goods or technology; (c) aid does not have indirect effects that reduce investment or savings rates; and aid is associated with technology transfer that increases the productivity of capital and promotes endogenous technical change.

According to McGillivray, et al. (2006), four main alternative views on the effectiveness of aid have been suggested, namely, (a) aid has decreasing returns, (b) aid effectiveness is influenced by external and climatic conditions, (c) aid effectiveness is influenced by political conditions, and (d) aid effectiveness depends on institutional quality. It is interesting to note that in recent years there has been a significant increase in aid flows to developing countries although other types of flows such as foreign direct investment and other private flows are declining. For example, according to the Organization for Economic Corporation and Development (OECD, 2009), foreign direct investment and other private flows are on the decline and remittances are expected to drop significantly. Budgets of many developing countries were hit hard by the rises in food and oil prices in the last two years. Many countries are not in a strong fiscal position to address the current financial crisis. According to the OECD (2009), in 2008, total net official development assistance (ODA) from members of the OECD’s Development Assistance Committee (DAC) rose by 10.2% in real terms to US$119.8 billion and was expected to rise to US$130 billion by 2010 and US dollar160 in 2015. Africa is the largest recipient of foreign aid. For example, net bilateral ODA from DAC donors to Africa in 2008 totaled US$26 billion, of which US$22.5 billion went to sub-Saharan Africa. Excluding volatile debt relief grants, bilateral aid to Africa and sub-Saharan Africa rose by 10.6% and 10% respectively in real terms. Based on the above assertion, It is therefore necessary to undertake an assessment of the extent to which financial aid has impacted on poverty reduction in Nigeria. That is the overall objective of this paper.

Impact of world financial aid and socio-economic development on poverty reduction
Many studies, old and new, consider the relationship between financial development and growth, but the question of whether financial development helps reduce poverty has not been the subject of much empirical work.
How financial aid affects economic growth and how it helps reduce poverty are clearly related issues because growth is a powerful way to reduce poverty (Bruno, Ravallion, and Squire, 1998).
However, it is possible that in certain countries the benefit of growth for the poor is undermined or even offset by the increases in inequality that may accompany growth. As Kanbur (2001) emphasized, though there have been many demonstrations that across countries and over time growth in real national per capita income is correlated with reductions in the measure of national income poverty, “the real dispute is about consequences of alternative politics. This raises interest in assessing the specific impact of financial development on poverty. The main goal of the paper is to identify and quantify the positive and negative channels through which financial development affects poverty. On the one hand, we argue that financial development helps reduce poverty indirectly by stimulating growth and directly by facilitating transactions and allowing the poor to benefit from financial services (primarily savings products) that increase their income (through interest earned) and enhance their ability to undertake profitable investments and other activities. On the other hand, to the extent that instability arises at various stages of the financial development process, it demonstrably undermines poverty reduction because the poor are generally more vulnerable than the rich to unstable and malfunctioning financial institutions (e.g., payment systems) and indirectly through negative macroeconomic impacts (e.g., volatility of growth, inflation). This paper therefore aims to (i) explore whether better access to savings or credit opportunities (with a nonnegative real return) is the main direct channel through which financial development works to alleviate poverty; and (ii) assess whether financial instability is detrimental to the poor and thus weakens the beneficial impact of finance on the poor.

Like others, it tries to distinguish the direct effect of financial development on poverty reduction from its indirect positive effect through economic growth. However, two features of our analysis set it apart from what has been done so far:

1. This work is interested in the channels (credit or money) through which poor people benefit from formal financial intermediation. We therefore focus on the “motive of finance” for money demand suggested by Keynes (1937) and rehabilitated by McKinnon (1973) when he presented the “conduit effect.” This assumes that even if financial institutions do not provide credit to the poor who must self-finance investment, they are useful because they offer profitable financial opportunities for savings.

2. It also recognize that financial development is accompanied by crises that are likely to undermine the potential benefits of financial development, in particular for the poorest. Therefore, in addition to the indicator of financial development in the analysis explaining poverty we include an indicator of financial instability. The intent is to reconcile the apparent contradiction between two schools of thought: the first underlines the positive effect of financial development on growth, and the second shows that credit growth is a predictor of banking and currency crises (Loayza and Ranciere, 2006).

Dollar and Kraay (2002) measure aggregate poverty by the average per capita income of the poorest population and show that it depends on real GDP per capita and other variables, which in our case integrate financial development and financial instability indicators. The model is estimated on a large sample of developing countries with panel data over the period 1966–2000 using the system GMM estimator. Two other indicators of poverty are also used: headcount poverty measured by the share of the population earning less than $1 a day, and the poverty gap,
which unlike the former takes into account the distance of the poor from the poverty line. The results suggest that unlike financial instability, financial development is on average good for the poor. However, this result holds only when financial development is measured by the ratio of money to GDP (liquidity ratio).

How might world financial aid directly improve the well-being of the poor?

Borrowing is often necessary to invest in physical capital or human resources and insulate spending against external shocks. As many authors claim, credit constraints chiefly bind the poor (Banerjee and Newman, 1993; Aghion and Bolton, 1997). However, because access of poor households to bank credit may be impeded by the high unit cost of small loans, financial development may be regressive for the poor. This is the prediction of the well-known model of Greenwood and Jovanovic (1990) at an early stage of development. They posit that benefiting from the screening and risk pooling offered by financial intermediation requires a set-up cost that poor households cannot afford. Because they cannot use savings for this outlay, they fall further below in the income distribution. This is why international aid is so heavily directed toward stimulating microcredit institutions, even though their financial equilibrium may be problematic. However, Greenwood and Jovanovic also pointed out that over time it becomes easier for the poorer segments of the population to access credit, which may result in an inverted U-shape curve of income inequality and financial development. Indeed, as the financial system becomes healthier and more competitive, it may have more capacity and desire to bear the high costs of small credits (Rajan and Zingales, 2003). For instance, in Latin America commercial banks have begun to make pooled loans available to the poor, as microcredit institutions have been doing (Mosley, 1999). Also, the evolution of informal credit, often the only source of borrowing for poor people, is made easier by the growth of a formal financial system that provides informal institutions with opportunities for profitable deposits. Moreover, access to credit enables the poor to smooth their consumption, thus reducing their vulnerability to exogenous shocks and building human capital. From our point of view, a second argument seems to better support the hypothesis that financial development has a beneficial effect on the poor. Banks may at least offer the opportunity of demand or savings deposits that have a nonnegative real remuneration or a small real positive one for poor households and small firms. Tressel (2003) pointed out that banks have superior ability to mobilize savings and informal lenders enjoy superior information on borrowers. According to McKinnon (1973), when economic units are confined to self-finance so that there is no useful distinction between savers (households) and investors (firms), indivisibilities in investment are of considerable importance. Here, money and capital become complementary: If the real return on holding money increases, so will self-financed investment over a significant range of investment opportunities. The increased desirability of holding cash balances (for the poor) reduces the opportunity cost of saving internally for the eventual purchase of capital goods from outside the firm-household. The financial ‘conduit’ for capital accumulation is thereby enlarged (McKinnon, 1973).

However, the flip side of the beneficial impact of financial development for the poorest in the population is the detrimental impact that disturbances of the financial system have on the same people.
Why does financial instability hurt the poor relatively more than the rich?

Several reasons support the assumption that the poor are more vulnerable to banking crises than the rich. Indeed, poor people are particularly hurt by disruptions of the payment system and unwarranted bank closures. When deposits are frozen, they are unable to diversify their assets and invest their savings in foreign banks. In countries where some banks are periodically unable to ensure the liquidity of their deposits, the McKinnon conduit effect is probably dampened or even cancelled out by the doubt surrounding the health of the banking system. Moreover, when banks are in difficulty, they begin to ration small loans because these borrowers are less profitable for them and also because the poor have little negotiating power. Beside the direct effect, an indirect effect may result from the instability of growth and inflation induced by an unstable financial system. Because investment is closely linked to credit availability, financial instability is likely to exacerbate fluctuations in the investment rate, thereby destabilizing growth. Furthermore, financial instability leads to volatility in relative prices because goods prices are affected by credit variation in different ways: the prices of tradable goods are determined by foreign prices and the nominal exchange rate; those of non tradable goods depend on domestic supply and demand and therefore are more directly affected by the level and change in domestic credit. The instabilities of the investment rate and of the real exchange rate both make growth more volatile. Ramey and Ramey (1995) having shown a negative relationship between average rate of growth and the volatility of annual rates across countries, it is likely that growth volatility induced by financial instability impedes economic growth. Because economic condition for durably reducing poverty, financial instability thus hurts the poor. Moreover, poor people are more vulnerable to growth volatility in view of the asymmetry between periods of falling and rising aggregate income; falling periods reduce the income of the poor more than rising ones improve it. Evidenced have shown that economic growth on average reduced rural and urban poverty but that the negative impact of regressions on poverty was stronger than the positive impact of expansions. The reasons for the asymmetric effect on the poor are could be the outcome of several factors that differ from one country to another. In general, the less skilled and poorest workers are made redundant at the beginning of an economic downturn. Hence they would have been unemployed for the longest duration when the expansion begins. However they may be the last to get employment, therefore growth fluctuations tend to increase income inequality. Further while prices rarely fall during recessions, they often rise during expansions, most noticeably because expansions are rapid. Also, the poor may depend more than the rich on state-determined income that is not fully indexed to inflation, such as pensions, state subsidies, or direct transfers (Easterly and Fischer, 2001), in which case unanticipated inflation linked to inflation volatility is specifically detrimental to the poor.

Further, though poverty is generally concentrated in rural areas, governments often do not pass through to farmers rises in the international prices of agricultural products—but due to budgetary constraints, falls in international prices are transmitted to producer prices. And because poor people lack access to insurance, a drop in real income may lower their investment in health and education, with adverse consequences for their human capital, In several African countries it appears that:

Where there has been recession, mean and redistribution income effects typically have opposite signs, and the redistribution effect substantially mitigates the poverty increasing impact of lower mean incomes (in, Nigeria, better-off groups clearly bear a heavier burden of income losses during periods of economic decline. This outcome may be explained by more acute pro poor state
interventions or international aid allocations where poverty is clearly rising due to economic decline. Finally, it is highly possible that the relationship between poverty and growth instability is not similar between countries. Nevertheless, according to Ravallion (2001), “there is no sign that distributional change helps protect the poor during contractions in average living standards”

**Policy implications and conclusion**

This study yields two important findings. First, aid has no positive effect on economic growth; and second, aid does have a positive effect on poverty alleviation. The first finding is consistent with some of the previous literature. Aid is not a growth promoter. Most recipient countries lack the right mechanisms to use aid effectively and efficiently to improve their economic conditions. “No matter how much aid the developing countries get, without better governments, it is impossible to help the poor” (Werlin, 2005). Similarly, many argue that some corrupt governments receiving a large portion of their budget revenue from foreign aid have no incentive to promote economic growth, and pay no attention to the well being of their people and build their institutional capability (Mesquita and Root, 2002). Mesquita and Root argue (2002), “External aid often promotes the longevity in office for autocratic leaders who are otherwise at risk of being deposed …. In such cases, aid not only fails to promote economic growth, but it also diminishes the odds that the political system will evolve in a more inclusive, democratic and growth oriented direction.” Moreover, aid given to the poor often ends up going to the rich and the elite of the society rather going to the poor. For example, in 30 countries in Sub Saharan Africa, the ruling elites of those countries have assets offshore equaling 145% of the public debts in their countries (Kasper, 2006). The second finding shows that an increase in aid would cause a decrease in poverty level. The multilateral and bilateral aid conditional on improving the quality of governance might be working to encourage recipient countries to be more responsive to the yearning of the poor. This is a sign that donors of unconditional aid might be well-advised to reconsider their aid policies. In summary, the study suggests that donors as well as the recipient countries need to play a larger role for the aid in order for aid to be used efficiently and effectively. There are several major policy implications that the donors and recipients need to consider to make aid more effective in improving economic growth and quality of governance.

**Accountability and Responsibility of the Recipient Countries**

The governments of the aid recipient countries need to be held accountable for the use of aid. Often the recipient countries are not punished when they do not use aid to do the assigned project properly. Indeed, they continue to receive substantial amounts of aid. This gives them no incentive to use the aid efficiently and effectively, and also creates the so called “soft budget constraint”. The recipient countries need to be punished if they fail to perform actions they have agreed with on the aid contracts. The punishment could be in terms of cutting down the overall amount of aid or suspending the aid given to specific sectors which performance does not meet the targets. In addition, the donor countries can also create a mechanism to encourage the recipient countries to be more accountable and responsive. For example, the government of Netherlands has adopted a new policy on aid distribution. It focuses its aid selectively based on performance, and has reduced the number of its aid recipients from 80 to 20 (Brautigam and Knack 2004). This creates an incentive for developing countries to have more accountability and responsibility in order to be competitive to get more aid.
Commitment of the Recipient Countries
The political will of the recipient government to reform their institutional structures and policies is a necessary condition for aid to be effective. Without the political will at the top level, reforming governance is very challenging. For example in a case of corruption, the failure of past Nigerian governments to reduce corruption is due to the unwillingness of the presidents to punish the wrongdoers who are closely associated with them. That action led to the undermining of the legitimacy and credibility of the governments. Similarly, in Nigeria again, the leaders are often hesitant to make a reform as they are afraid to harm the interests of their cronies and clients. Though the donors can impose certain policies on the recipient countries, the political will of the recipient countries’ leaders to take major challenge is still needed to make aid effective.

Helping Recipient Countries Build Democracy
Donors cannot keep giving aid to recipient countries forever. Past experiences in various countries had shown that a bad government country tends to use aid to prolong the control of the country’s elites and to ignore the suffering of the majority of the people. Donors need to initiate a program helping recipient countries to build democratic political institutions. It is a known fact that inclusive regimes, democratic regimes, tend to care more about the welfare of the citizens and promote a high economic growth rates.

Helping the Recipient Countries Build Institutional Capabilities
To give recipient countries an incentive to be less reliant on aid and donors’ technical assistance, donors need to set deadlines for aid phase-out. But the donor countries need to run a program to transfer economic, political and social knowledge, technologies and know-how to the local people of the developing countries so that after the donors withdraw, the recipient countries can keep running their institutions. For example, the two oft-cited successful stories of that are South Korea and Taiwan. South Korea and Taiwan used to be heavily dependent on aid. However, after donors help them build strong economic and political institutional capability, the donors eventually could completely phase out the aid. The countries could keep economic growth going. Thus the donor countries need to fix a schedule for the aid inflow and enforce it, so that the developing countries know that they would be facing “hard budget constraint” and they would be pressured to learn and run their countries more efficiently.

Bypassing Bad Governments
Donors can bypass a bad government in a recipient country by giving aid in terms of grants directly to projects (Mesquita and Root, 2000). Direct grants would reduce chances that government can use the money for corruption. Grants are usually given for projects with specific goals, and they are easier to monitor than unconditional aid given directly to governments. Direct grants can also potentially reach and help poor and aid-needing people better than the general monetary aid.

The above measures if adopted will help promote socio-economic transformation and as well reduce poverty if not completely eradicated.
References


World Development Indicators 2000, World Bank.