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What Influences U.S Official Development Aid to Nigeria?

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Abstract: *It is generally believed that aid is a charity from the rich to the poor countries to help the poor overcome their development problems. As a result of this, a number of erroneous beliefs now surround the issue of foreign aid from the donor countries (rich) to the developing countries. Despite these beliefs, U.S aid to Nigeria has been significant especially since the country returned to democracy. Late 2014, U.S promised to increase the aid to Nigeria to about $720m. It is on this that this study sought to investigate the factors influencing the increase in U.S aid to Nigeria during the period of 1980-2013. The theoretical analysis rests on two-gap model and combines several methods of econometrics. The findings shows that aid flow to the country are influenced by the variables: unemployment, poverty rate, population growth rate, demographic factors proxy by the number of people living with HIV as well as the growth rate of GDP per capita. Based on the results, the author then suggests that aid flow to the country should be properly managed to achieve the objectives at which aid is being allocated to the country.*
Keywords: *U.S, Nigeria, Foreign Aid, population, political relationship and diplomatic ties*

I. Introduction

The economic objectives of foreign aid are to alleviate poverty, increase savings, investment and the rate of economic growth of the recipient country. Development assistance however, has not always succeeded in achieving these objectives because in many cases donor motives for giving aid and recipients motives for accepting it conflict with the economic objectives of foreign aid. Todaro (1989) stated that there are likely to be fundamental differences in attitudes and motivations between donor and recipient countries. Thus, foreign aid is a complex term especially when it is used to cover a variety of resources transfers from developed countries to developing countries. Many of these may be military and /or political in nature and have nothing to do with assisting economic development. With a view of examining the motive of both donor and recipient on foreign aid, Maizels and Nissanke (1984) investigate the underlying principles of foreign aid allocation and motives of donor and recipients by setting two alternative models to bilateral and multilateral aid flows for eighty countries. The two authors came up with the facts that donor's self interest plays a relatively large role in bilateral assistance while foreign aid from multilateral sources are allocated and with a large role on recipient countries.

However, the record of Western aid to Africa has been significant, amounting to more than $500 billion between 1960 and 1997, which is the equivalent of four Marshall Plans being pumped into Sub-Saharan Africa. In the past year, the national budgets, apart from the relief aid and economic development, foreign aid assistance was also provided to support reforms and policy adjustment programs to some developing countries. During 1981and 1991 alone, the World Bank provided $20 billion toward Africa's structural adjustment program. In 1960, United States established diplomatic relations with Nigeria, following Nigeria's independence from the United Kingdom. From 1966-1999 Nigeria had experienced a series of military coups, excluding the short-lived second republic during 1979-1983. The 30-month long civil war, which ended in January 1970, resulted in 1-3 million casualties. Following the 1999 inauguration of a civilian president, the U.S.-Nigerian relationship began to improve, as did cooperation on foreign policy goals such as regional peacekeeping. The United States seeks to help improve the economic stability, security, and well-being of Nigerians by strengthening democratic institutions, improving transparency and accountability, and professionalising security forces.

Consequently, Nigeria receives approximately US$83b per year in foreign aid from donors including the US, Europe, the World Bank, Japan, and the UN, and certain Gulf countries (AidData). The US aims to contribute approximately $720m in aid in 2015, while European Union aid to Nigeria during 2009 and 2013 totaled approximately $225m per year (Business Day, 2014) (EU External Action). The United States contributed a relatively small amount aid to Nigeria at the beginning of independence in 1960s. Flows during this time were much lower than they have been receiving since the country transformation to democracy. A major US-sponsored aid project in the country during this time was the development of several agricultural project and schools at Nigeria institutes of higher education (USAID). The US restricted aid in the early 90s in response to drug trafficking inside Nigeria, donating about $7 million per year during this time (approximately $.06/person) (USAID). In 1999, Nigeria's first president was elected, and twenty years later, the US President was requesting $720 million in foreign aid to Nigeria (approximately $4/person, adjusted for population growth)

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(Business Day, 2014). US aid to Nigeria thus increased dramatically during the same period that Nigeria became a democracy.

Many today believe[2] that foreign aid whether bilateral or multi-lateral has not helped and cannot help to bring about the expected level of growth in Nigeria. These people believe and contend that despite the enormous foreign aid assistance received by Nigeria since independence, the level of development remained very low. From this foregoing statement, the following questions are put forward: (i) Is aid money to Nigeria justified? (ii) Should America continue to pump money in the form of aid to Nigeria? (iii) What determines the amount of aid to Nigeria from the donor countries? The reasons for this state of affairs pose a serious problem which begs for an answer, hence this study. The need for the answer becomes necessary so that Nigerian leaders and policy advisers would take necessary precautions on how to channel foreign aid, for maximum economic benefits and development of the country. Thus, this study aims at looking into the factor that determines U.S. foreign aid and its impact on the economic growth in Nigeria between the periods to 1980-2013. This research paper is organized as follows. Section one is the introduction/statement of the problem. Section two provides information on aid policy in Nigeria and the trend of aid to Nigeria. Section three provides a theoretical review and the review of related works on the study matter. Following is section four which comprise of the theoretical framework, methodology, model specification and data source. Section five consists of the discussion of the estimation results. Lastly section six gives a summary, conclusion and recommendations.

II. Section Two

2.2 Foreign Aid in Nigeria

Nigeria is Africa's most populous country and the largest African contributor to peacekeeping missions, as well as a crucial global supplier of oil, and the fifth-largest supplier of U.S. crude oil imports. However, Nigeria's inadequate infrastructure; perceived tolerance of public corruption; lack of incentives and policies to promote private sector development; and poor access to quality basic education and health services threaten progress and fuel the grievances, which amplify political unrest, in addition to ethnic and religious tensions. Further, a high poverty rate, coupled with a large population of unemployed and underemployed youth (42 percent of those between the ages of 15-24), and increased insecurity in the North, heighten the risk of escalating unrest. All these coupled with the bilateral arrangement between the country and U.S. can be factors which attract US to Nigeria along with other countries in Africa and beyond. U.S. assistance in Nigeria is aimed at promoting stability and foster democratic principles in a growing and diversified economy.

Particularly, U.S. assistance seeks to strengthen Nigeria's democratic institutions and improve access to education and health services. U.S. assistance also promotes improved agricultural productivity, job expansion in the rural sector, and increased supplies of clean energy. In 1970, Nigeria was obligated a total of $337,801,958 from the United States government in 2012, a decrease of 36% from last year's aid ($459,895,683). The aid to Nigeria was obligated significantly higher than average for all countries in Sub-Saharan Africa (avg. $67,761,170) and significantly higher than average for all countries in the world (avg. $28,487,761). In the same 2008 and 2012 Nigeria was among the top ten recipient in Africa with $516 and $337 respectively and top twenty-five recipients of US aid in 2012. "My pet example is the 220 billion pounds ($500 billion) of development assistance that has been stolen from this country since independence to date by past leaders." -Nuhu Ribadu, (2006). This shows the level of corruption in Nigeria.

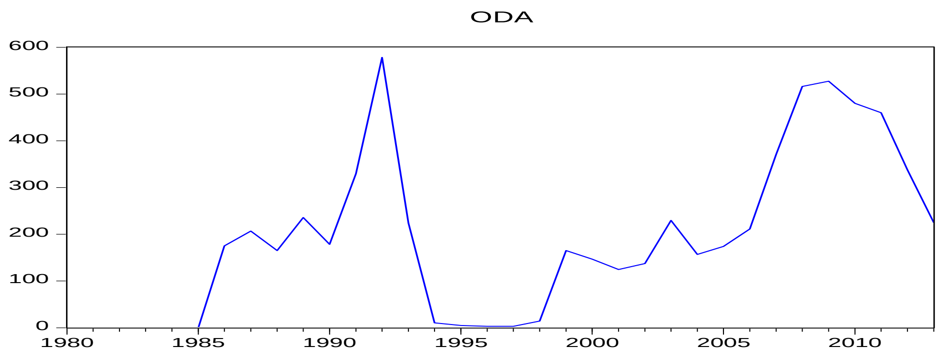

Figure1: U.S Aid To Nigeria

III. Literature Review

[2] See the spectator, January 25 2014.

Theoretically, studies on the effect of foreign assistance are ambiguous. They provide evidence on both the positive and negative effect. However, the positive aid-growth relation is mainly conditional. There are various factors which determine economic growth of a country. They include the quality of labour force, resources (natural and financial), capital, technology and the institutional setting of economic activities. Early economic growth theories in the 1950s and 1960s stressed that the basic problem for many developing countries was precisely capital formation in achieving economic growth. Thus these theories were in the view that development assistance was important for these countries to fill the finance gap and technology gap. More popularly, these gaps were known as saving gap and the trade gap. However, there are different views on the role of foreign aid in filling the savings gap and the trade gap and thus contributing to growth in developing countries. According to the Orthodox position, Chenery and Strout (1966), all capital inflows constitute net additions to a less developing country's productive resources thus increasing its growth rate. This line of argument is based on the two gap models where these foreign capital inflows facilitated and accelerated growth by removing foreign exchange and domestic savings gaps.

3.1 Review of Related Literatures

The effectiveness of foreign aid is the subject of much debate in development economics. Some economists argued that aid does not significantly increase economic growth rates or improve (e.g., Boone, 1996). Others, on the contrary, believe it does, especially when the recipient country implements appropriate policies (e.g., Burnside and Dollar, 2000)[3]. Still others would argue, for example, that the effects of bilateral and multilateral aid are markedly different – while one type may promote growth and development, the other one may not.[4]

Armah and Nelson (2008) characterized the effect of foreign aid on the growth of Sub-Saharan African countries after correcting endogeneity problems that plague the estimation. The result shows that foreign aid promotes growth and good governance. The authors suggested that aid to Sub Saharan Africa is one way to achieve the UN's Millennium goals. Asiedu and Nandwa (2010) examined the effect of education aid on growth and found that the effect of 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. In a similar paper by Okon, (2012) who employed two-stage least squares estimation to analyzing data from 1960-2010 in Nigeria found that there is a negative relationship between development aid and human development. This result implies that aid tends to worsen human development in Nigeria.

A study conducted by McGillivray (2005) demonstrated 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. In a similar study conducted by Olofin (2013) who re-examined the effects of different types of foreign aid on poverty level in eight West African countries between 1975-2010 employing both the first and second generation econometrics methods of panel unit root test, cointegration test and empirical estimators with heterogeneous slopes on some selected variables from the countries understudied, the econometrics analysis found that impacts of foreign aid on poverty in West Africa were minimal. This result means that the impact of foreign aid on poverty reduction in West Africa is insignificant.

Ouattara (2006) analyzed the effects of aid flows on key fiscal aggregates in Senegal. This 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) examined 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. This 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

[3] Burnside and Dollar (2000) find that the effect of aid is conditional on some characteristic of the recipient country, such as the country's policy environment.
[4] Ram, 2003; Cassen, 1994; Sender, 1999

MGDs cannot be achieved with development aid alone, but other innovative sources of development finance need to be explored as well.

Ekpo (2011) in his study examined the nature, scale, use and impact of aid flows to Nigeria during the period 2002-2008. The analysis shows that aid increased during the period 2004-2008 were partly due to the Paris Club debt forgiveness in the country and the aid impacted positively on GDP per capita during the period under review. Also, in a similar study conducted by Ekpo and Afangideh (2012), they examined the challenges, policies, principles, and impact of official development assistance (ODA) on economic performance in Nigeria from 1970-2010. The authors developed a small macro-econometric model to determine the impact of aid flows to key sectors like agriculture and manufacturing and their transmission effect(s) on the economy. Besides descriptive analysis, they utilizes three stages least squares (3SLS) estimation technique in a simultaneous equation model to analyse the results. The result of the growth equation shows there is a positive but insignificant relationship between ODA and economic development in Nigeria and also found a significant relationship between capital expenditure and economic development while oil revenue indicated a negative relationship with agricultural output.

In another study conducted in Nigeria, Kolawole (2013) examined the impact exacted by foreign assistance in the form of official development assistance (ODA) and foreign direct investment (FDI) on real growth in Nigeria over the period 1980 to 2011. Using the Two-Gap model and various econometric techniques which include Augmented Dickey Fuller (ADF) test, Granger causality test, Johansen co-integration test and Error Correction Method (ECM), empirical results reveal that there is no-causality between any pair of the variables. Findings of the study also established a negative relationship between FDI and real growth as ODA exacts no impact on real growth in the country. Eregha (2009) examined the growth and determinants of foreign aid allocation to Nigeria. Using OLS method of estimation with an autoregressive model to examine the short run and long run coefficients of the determinants, the study shows that most of the variables used: national income per capita, total debt service, population and domestic saving all have positive impact on foreign aid.

In summary, the literature on the determinants of foreign aid is very scanty, especially on Nigeria. Eregha (2009) only looked at the total inflow of aid to Nigeria without considering the direction of flow. Thus, this study seek to look at the determinants of US ODA flow to Nigeria since US is one of the largest donor of aid to the country. However, the findings of the studies reviewed in term of aid-growth analysis can be sensitive to the period of analysis and may change if the period of analysis covers a larger number of years. Also, the factors that influences donor countries to recipient countries may not be limited to what Eregha considered in his study. Thus, this study will contribute to the existing literature by including the level of poverty rate, unemployment rate, government policy, and people living with HIV will be used to capture demographic variable in the model.

IV. Theoretical Framework And Methodology

4.1 Theoretical Framework

The complex nature of the word-foreign aid can be noticed in the academic researches and scholars debates. It is common for scholars to focus on certain perspectives of aid and policy frame works instead of developing consistent foreign aid theories (Van der Veen, 2011). Consequently, it has not yet been a separate developed theory for foreign aid in various academic literatures. It should also be noted that foreign aid has been a central issue in international finance since the last six decades (Shaw, 2011 & Moyo, 2009). However, following the work of Chenery and Strout (1966), two-gap model will be considered. The 'two gap model' supports the hypothesis of investment-limited growth based on the Harrod-Domar model which assumes a specific amount of investment to increase growth.

4.2 Model Specification

Econometrics Model

The econometric model which is used to analyse the factors influencing foreign aid uses a single equation model. The dependent variable is foreign aid and the explanatory variables lagged for one year are gross domestic product growth rate, population growth rate, poverty level, unemployment rate and people living with HIV in the country. The analysis was made by lagging the explanatory variables for one year so as to maintain a reasonable number of the degrees of freedom given the problem of data. Explanatory variables are lagged because the current foreign aid is dependent on the behaviour of these variables in the previous year. Furthermore, the analysis of the impact of foreign aid has been made by differentiating its impact on GDP growth rate during 1999 and 2013. This was made by estimating the interaction term between foreign aid and the time dummy for aid in order to determine the influence of foreign aid on GDP growth in the year under study.

Determinants of Foreign Aid in Nigeria

$$U.S.ODA = \alpha_0 + \alpha_1 UNEM + \alpha_2 GRGDPPC + \alpha_3 POPGR + \alpha_4 POVR + \alpha_5 PPHIV + \mu$$
……………4.1

Where,

U.S.ODA is the foreign aid assistance from U.S to Nigeria. UNEM is the rate of unemployment in Nigeria. GRGDPPC is the gross domestic product growth rate is used to capture the level of economic growth in the country. POPGR is the population growth rate. POVR is poverty headcount ratio at $2 a day (PPP) (% of population) while PPHIV is the total number of people living with HIV, (% of population ages 15-49). This is included in the model because one of the U. S reasons of foreign aid to Nigeria is to reduce the HIV infection in the country. μ is the stochastic error term and α is the coefficients to be estimated.

4.3 Estimation Techniques

Since this study involves time series data, OLS and unit root test is employs to check the stationarity of each of the variable used through the use of Augmented Dickey-Fuller (ADF) test. ADF is employs to avoid the problem of spurious regression thereby subjecting the variables to unit root test in order to determine their order of integration. The general form of ADF test equation is in the following forms.

$$\Delta Y_t = \beta_0 + \beta_1 t + \delta Y_{t-1} + d_i \sum_{t-1}^{n} \Delta Y_i + \varepsilon_t \quad \text{……………………………..4.2}$$

Where Y is a time series, t is a linear time trend, Δ is first difference operator, β_0 is a constant, n is the optimum number of lags in the dependent variable and ε_t is a random error term or white noise. Though, time series data are always non-stationary, they are usually stationary at first difference where the variable(s) will be integrated of order I(1). A unit root test is conducted to confirm the stationarity of the variables. In order to make inferences, critical values of 1%, 5% and 10% are used. The null hypothesis is that there exists a unit root (non-stationary) that is H_0: δ =0 against the alternative hypothesis, H_1: δ <0 that the time series is stationary (i.e no unit root). The decision is that if H_0 is rejected, it means that Y_t is a stationary time series around a deterministic trend.

4.5 Sources of Data

The unemployment rate data are source from World Economic Outlook (WEO) database. US foreign aid to Nigeria are obtained from US overseas Loans and Grants to Nigeria (www.us-foreignaid.findthebest.com/1/127/Nigeria) USAID 2012. The data on oil and non-oil revenues in Nigeria are from Central Bank Statistical Bulletin. Others are from World Development Indicators (2014).

V. Discussion Of Results

Table 1 Unit Root Test Result (ADF)

Augmented Dickey-Fuller Unit Root Test			
Variable	ADF	Critical values	Decision
ODA	- 4.645429	-3.5578***	I(1)
UNEM	-7.3623	-3.2124***	I(1)
POPGR	-4.5317	-3.5581**	I(1)
POVR	-6.4588	-3.2123***	I(1)
GRGDPPC	-4.8622	-3.2096***	I(0)
PPHIV	-3.9880	-3.2253***	I(2)

Note: ** *** indicate significant at 5% and 10% respectively.
Author's computation from the estimation result

The ADF result above shows that almost all the variables are stationary at first difference except *GRGDPPC* and *PPHIV* which are significant at level and second difference respectively with the assumption of constant and trend.

The R^2 value of the regression analysis indicate that unemployment rate, poverty rate, number of people living with *HIV/AID*, the growth rate of *GDP* per capita, and population growth rate accounts for 50% of total variation of the foreign aid from U.S to Nigeria. The result showed a statistically significant relationship between population growth rate and foreign aid to Nigeria. The number of people living with *HIV/AID* is positive. This means that the U.S aid to Nigeria increases as long as the number of people with *HIV/AID* increases in the economy. This result is counter intuitive because the number of people with *HIV/AID* is not expected to influence the amount of *AID* to the economy as this will have an influence in the economy especially if the effected people are working population there will be a reduction in the number of labour/capital and negatively it will affect *GDP* of the economy. This conforms to apriori expectation because one of factor influencing aid from U.S is to fight *HIV/AID* in the country.

VI. Summary, Conclusion And Recommendation

This study investigated the factor influencing the foreign aid from U.S to Nigeria during the period 1980-2013 using the variables unemployment rate, poverty rate, population growth rate, demographic factors proxy by the number of people living with HIV as well as the growth rate of GDP per capita. The findings revealed that aid flow to the country are influenced by poverty rate in the country, number of people living with HIV/AID and population growth rate. The result however showed what foster increase in U.S aid to Nigeria over the past decades. Although, a great deal of approximately 50% of the U.S aid to Nigeria is designated to address the problem of HIV/AIDS

Based on the results, the aid flow to the country should be properly managed to achieve the objectives at which aid is being allocated to the country. If aid from U.S is to have positive impact on the economy then the distribution of assistance must take into consideration the rural-urban dichotomy in Nigeria with a view to integrating the rural economy with the larger macro-economy. Also, to reduce poverty and hunger, it would be necessary to restructure fundamentally the global economic relationship particularly on commodity trade – countries like Nigeria should have access to the markets of developed countries. In addition, government should distribution try to penetrate the rural as majority of the people living in poverty are concentrated in the rural areas. Few of them actually benefit from the poverty reduction programme of the country.

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