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Foreign Aid: Road to Stability or Recipe for Disaster

Outline

I. Introduction

- Foreign Aid remains a recipe for disaster rather than a road to stability, because it compromises national sovereignty, perpetuates economic instability and debt dependency, and fosters political instability.

II. Brief overview of the topic:

- Foreign Aid is a foreign policy tool of major powers to gain influence.

III. How is foreign aid a recipe for disaster.

3.1 Compromises national sovereignty of recipient countries, as donor institutions and countries interfere in domestic policymaking.

(Case in point: EU interference in Greece after 2008 crisis)

3.2 Perpetuates debt dependency as recipient countries increasingly use ^{aid} loans to finance government expenses, instead of mobilizing domestic resources.

(Case in point: Sri Lanka after 2011)

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3.3 Dependency on foreign aid creates a debt cycle, which exacerbates solvency issues for the recipient countries (Argentina in 2025)

3.4 Entrenches poverty and poor human development as donors force recipients to institute neoliberal reforms. (SIPRI report on how foreign aid leads to reduced government spending and on welfare)

3.5 Use of foreign aid to subsidise domestic industries fosters economic inefficiencies and misallocation of resources, promoting incompetiveness. (The Economist report on Pakistan's sugar industry)

3.6 Increases inequality as foreign aid allows political elites to delay domestic reforms and undertake projects that benefit them. (Motkyr's theory of elite capture and foreign aid)

IV. Refuting the claim that foreign aid is a road to stability.

4.1 Proponents argue foreign aid leads to economic stability; however, it is only short-term as no structural reforms are undertaken.

(Case in point; Greek economic crisis of 2008 and 2020)

4.2 Proponents claim aid is also spent on infrastructure and human development; however, the debt burden on the poor offsets these gains.

(Faisal Bari on the 'economics of foreign aid')

V. Recommendations to counter ramifications of foreign debt.

S-1 Reducing reliance on foreign aid by mobilising domestic revenues.

S-2 Keeping diversified sources of foreign aid to avoid over-dependence on a single entity.

S-3 Making sure donors do not interfere in domestic affairs and policy making.

Throughout history, powerful states have used different tools to exert influence and project their power. After the World War II, foreign aid also emerged as a powerful tool which states could use to gain their strategic aims and exert influence over weaker states. During the 1950's, the United States used Marshall plan to bolster Europe's defence and economy against the Soviet Union, and on the other hand, the Soviet Union used COMECON to strengthen its allies using foreign aid against the western bloc. However, foreign aid almost always has rapacious repercussions for the recipient countries. It compromises their national sovereignty, perpetuates their dependency on aid and debt, and entrenches poverty. Additionally, it also widens wealth inequality and promotes misallocation of resources. While supporters of foreign aid argue that it promotes economic stability and is used to cultivate sustainable human development, they ignore the fact that most of these gains are short-term, and in the long run foreign aid only worsens the socio-economic indicators of the recipient countries. Thus, countries should take steps to reduce reliance and control repercussions of foreign debt. In short, foreign debt remains a recipe for disaster rather than a road to stability, as it compromises national sovereignty, perpetuates economic instability, and

fosters debt dependency.

At the outset, it has been established that foreign aid is a recipe for disaster. Furthermore, the essay will discuss the contours and motives behind the disbursement of foreign aid. After that, the essay will shift its focus towards discussing the manifestations of foreign aid being a recipe for disaster. Following that, the essay will refute the claims of foreign aid being a road for stability before discussing the recommendations for mitigating the ramifications of foreign aid and concluding the essay.

According to the Britannica Encyclopedia, Foreign aid is defined as the use of monetary or non monetary means to benefit a nation. This can consist of both loan based aid and loan free aids. After the Bretton Woods agreement, the Great powers institutionalised foreign aid in the charters of the World Bank and IMF to stabilise global economic order. States also began to finance large scale foreign aid; the earliest example of which is the Marshall plan and COMECON in which both U.S. and USSR disbursed large amounts of aid to strengthen their alliances and gain strategic advantages. However, in the coming decades,

foreign aid became widespread in developing countries as developed nations now run ODA and aid offices in these countries. While they gave aid, they then also expected the recipient nations to show a degree of subservience to these donor states. Foreign Aid has now taken the shape of a foreign policy tool, used to attain foreign policy objectives. Thus, foreign aid is not a naive tool to help developing nations, rather it is a weapon to advance the interests of powerful states.

Having expounded upon the contours of foreign aid, the ground is now ripe to discuss how foreign aid is a recipe for disaster. Thus, the essay will now discuss the methods in which foreign aid hurts the recipient countries.

First of all, foreign aid compromises the national sovereignty of recipient countries. When countries receive foreign aid, they become beholden to the donor institutions and states. This imparts them leverage over the recipient states, which they use to influence domestic decision making of these countries to suit their own interests. A vital example of this phenomenon is the interference

of European Union states in Greece's economic decision making after they bailed out Greece from 2008 financial crisis. EU states dictated Greece's fiscal and monetary policy, undermining its sovereignty. Thus, this example illustrates how reliance on foreign aid violates sovereignty of recipient countries.

Secondly, availability of foreign aid perpetuates debt dependency in recipient countries. When states and governments can access foreign aid, they delay domestic reforms which would enable them to mobilize domestic revenues, because such steps would hurt their popularity. Thus they become increasingly reliant on foreign aid to finance government expenses and balance of payment deficits. This is illustrated by the example of Sri Lanka after 2010, whose tax collections reduced, fiscal deficits and debts increased gradually, ultimately leading to the default of 2022. In short, foreign aid erodes fiscal responsibility in recipient countries.

Thirdly, persistent use of foreign aid creates solvency risks for recipient countries. Too much reliance on foreign aid draws countries into a debt cycle, which shrinks the fiscal space of governments to invest in

Productive sectors of the economy. This creates a debt cycle, where governments struggle to raise revenues to meet even interest obligations, and development spending nosedives. Argentina is a prime example of this phenomenon, which took on so much aid that it struggled to even meet its interest obligations and defaulted in 2022. Thus, it can be said that foreign aid is a recipe for disaster as it leads to economic delinquency.

Fourthly, foreign aid entrenches poverty and poor human development. Donors of foreign aid force governments to institute neoliberal reforms such as deregulation, privatization and fiscal austerity. These policies lead to adverse social outcomes, and cause unemployment, loss of welfare and closure of public schools and hospitals. This deteriorates the level of human development and enhances systemic poverty in these countries. According to a report by SIPRI, 87% of western backed ODA offices force governments to cut back domestic welfare spending and undergo deregulation, which enhances poverty among beneficiaries of these schemes. Therefore, foreign aid causes poverty, unemployment and poor human development.

Fifthly, Foreign aid erodes competitiveness of domestic industries. Governments begin using foreign aid as a quick fix to contain inflation. They do so by using this aid to subsidise domestic industries. These subsidies cause misallocation of economic resources, distort markets and cause economic inefficiencies. According to The Economist, Pakistan's sugar industry is a key example of this phenomenon. Governments use foreign aid to protect this industry, which distorts price and perpetuates elite capture in Pakistan. In conclusion, foreign aid leads to market distortion and elite capture in recipient countries.

Last but not the least, foreign aid heightens wealth inequality in the recipient nations. Foreign aid acts like a sugar injection which enables political elites of the recipient countries to delay hard domestic reforms, and instead allow them to continue their spree of lavish spending, imports and infrastructure projects which benefit them. This fosters wealth inequality as elites grow richer at the expense of the poor. Mokyr, a Nobel prize winning economist, eclipses this phenomenon in his famed theory of elite capture and

foreign aid, where he mentions that the amount of foreign aid received by a country is directly proportional to the strength of elite capture prevalent in that country. In short, foreign aid widens wealth inequality in the recipient countries.

The essay has now made a clear relationship between foreign aid and how it is a recipe for disaster. Therefore, it is important now to rebut counterclaims to this argument.

Proponents in favour of foreign aid argue that it leads to economic stability, as it stabilizes fiscal and foreign deficits of the recipient country. This argument is flawed, because foreign aid is only a short-term remedy, and actually leads to economic instability in the long run. Foreign aid is not accompanied by any structural reforms; rather, it actually prevents them. This actually worsens the economic conditions of the recipient country in the long run. Greece is a vital example of this phenomenon, which was bailed out by foreign aid in 2008; however, in 2010 the Greek economy went into a more severe crisis as the fundamentals and underlying structural problems had not been mitigated.

Thus, it can be concluded that foreign aid actually leads to long term economic instability, rather than stability.

Secondly, proponents claim that foreign debt leads to poverty alleviation and human development, because a lot of aid is spent on programmes to directly address these issues. This argument is also illogical, as proponents fail to take into account the associated debt burden, and non economic costs associated with this transaction. These same disadvantaged people disproportionately bear the burden of servicing debts and costs associated with this aid, which offsets the gains of these programmes, and leaving them beholden to donor countries as well. Faizal Bari, in his theory of "economics and foreign aid" highlights this paradox, as well. He even goes on to say that due to these reasons, aid becomes a negative utility phenomena, as costs exceed benefits. Thus, Foreign aid perpetuates poverty and poor human development instead of alleviating them.

The essay has now discussed in detail the rebuttal to the counterclaims of foreign aid being a recipe for disaster.

Now, the essay will shift its focus towards discussing recommendations to reduce reliance on foreign aid and mitigate its ramifications before concluding itself.

First of all, countries should take steps to mobilize domestic revenues through local reforms. This will ensure that governments raise enough revenues to finance domestic expenses, without relying on foreign aid. According to Acemoglu, this is the most sustainable way to achieve economic growth and development. Thus, reducing reliance on foreign aid is the key to unlocking sustainable growth.

Secondly, States should focus on having diversified sources of foreign aid. This enables states to operate and keep its strategic autonomy intact, because no single entity will be able to exert excessive influence on the recipient country. Overdependence on a single source is disastrous, as the recipient country becomes subservient and loses sovereignty. Thus, containing over-dependence on a single source of foreign aid is indispensable for local economic development.

Last but not the least, guardrails should be enforced to prevent interference of donors in domestic affairs of the recipient country. Steps such as signing of pre-requisite Covenants guaranteeing non-interference, and use of diplomatic demarches to prevent interference should be used. These steps will prove to be instrumental in limiting over-reach of donor countries.

In conclusion, foreign aid remains a recipe for disaster. It plays a fundamental role in violating sovereignty of recipient countries, fostering economic instability, fomenting debt dependency and widening wealth gap in these nations. Thus, it is imperative for states to reduce reliance on foreign aid, to get on the road to real stability.