Contribution of Foreign Aid in the Reduction of Poverty:
A Case Study of Pakistan (1986-2015)

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ABSTRUCT- The aim of the study is to explore the impact of foreign aid on poverty in Pakistan during 1986-2015 through the channel of foreign loans, foreign grants, literacy rate, unemployment and industrialization. To measure poverty researcher used per capita income and to measure foreign aid researcher used foreign grants and foreign loans. The empirical results discovered that foreign aid, specifically foreign loans, have negatively related with per capita income. Researcher also fined that unemployment has negative relation with per capita income in Pakistan. This relation would not only increase unemployment but also increase poverty in Pakistan. Through other empirical finding that is industrialization has positively related with per capita income which shows that industrialization really decreased poverty in Pakistan. Researcher also concludes that grants have positive relation with per capita income. It indicates that grants actually decreased poverty in Pakistan. Another interesting finding of this study is the negative impact of literacy on per capita income. The impact could be due to unemployment because many literate persons are without job and due to this per capita income decreases.

Keywords: Foreign Grants, Foreign Loans, Per capita Income, Literacy Rate, Unemployment, Industrialization

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1. Introduction

Most of the developing countries in which poverty level is high, foreign aid has become a big supply of finance for bridging the gap between government expenditures and the low tax revenues in most of these countries. Foreign aid has been contributing to promote the growth of international growth and complementing state progress initiatives in the receiver countries but sometime it gives not a significant impact on poverty. Calderon.et al (2006) explored that foreign aid did not significant results in reduction of poverty and inequality. Pakistan, like other nations, who have insufficient capital, environmental problems and the main one being poverty obviously depend on foreign aid and some other factors. Zafar.et al (2016) described that remittances also a major contributor to expand economy of Pakistan. Zafar.et al (2016) explored that FDI also contributes to enhance economy. But many economists like Feeny (2003) said that foreign aid indirectly effects the income of the poor e.g. if aid promotes growth and due to this poor receives benefits then we can say that aid has indirect effect on income of the poor. On the other side if aid supports the

government expenditure that improves the wellbeing, then aid also indirectly benefits the poor.

Aid has helped to lay the foundations for growth and development, even if it is no guarantee that anything solid is built (Gomanee, 2002). Shah.et al (2005) described that The flow of funds to countries with lower per capita income of the country with the highest per capita on services and transactions / product in a country with a comparative advantage to other countries with a comparative advantage of low income.

The debt that the country gives to other countries on concessional rates (Saeed, 1995). The foundations can concessions:

1. Rates lower than current interest rates in the commercial interest of the world money market.
2. Repayment duration is longer.
3. Grant, which does not involve in the interest i.e. a free gift.

Sources of Foreign Aid: There are two ways of receiving Aid. **Bilateral Aid:** The aid which is given from one country government to the other state government. This is based on the political and economical relations of the donor and recipient country. China, Japan, USA, Saudi Arabia, Turkey, and UK were the largest contributors in the bilateral group of Pakistan. **Multilateral Aid:** That aid which is given by the financial institution and agencies to the recipient country government. This is better than bilateral aid because this is based on fair mode to move up the rate of economic growth. IDA, ADB, IBRD, and IDB were the largest contributors in the multilateral group of Pakistan.

1.3 Why Donors Give Aid? A Donor countries provide aid assistance policies primarily by political or economic interests. Some aid may be justified developing countries suffering from famine, earthquakes, floods, etc. But in the usual case, there is no historical evidence to support this for a long time there, aid donor countries to others without providing expected benefits. Mainly depending on their policies on political or economic interests.

Due to geopolitical events around its borders, moderate Pakistan received aid packages during the decade of the 60s and 80s in Pakistan closed western world partner to stop the march before the communist threat

(UNDP). During war in Afghanistan Pakistan received aid and loan with large intensity.

Why poverty has born? Following are the reasons in generating poverty:

Government Policies: Government is not well conscious of current circumstances of country. Policies are depends on the suggestions of those persons who do not have knowledge about the difficult circumstances of an ordinary man. So after accomplishment of policies, the policy makers do not get efficient result and government does not judge it as a failure of policy and announces any more policy without observing the outcomes of preceding one along with it badly affects the poor people. The people who's live below the poverty line still living below because of inappropriate policies. **Bad Education System:** Education sector plays important role in society or country. But unfortunately, educations in our country suffering from very bad condition .Due to this poor people are not capable to pay for worth education for their children. In addition, government ignores the problems of this sector. **Overpopulation:** Pakistan is in front of overpopulation. Population rate of Pakistan is really high. In view of the fact that in 1947 the population had grown three times. Increment on population is seems to be major issue for many countries. By insignificant resources it is not easy to manage the rising population. There is a huge economic discrepancy between the people. Poor's died due to lack of food whereas rich are busy in increasing additional wealth. These societal troubles straightly affect the common man. **Unemployment:**. Many young doctors, engineers and other knowledgeable people are here without job and some who are not educated they also become heavy burden or economy. For youth, there are minimum opportunities to explore their skill. Brain drains are also there due to unemployment because we are incapable to use our valued hands in the development of Pakistan. The horrific part is that it increasing every day and will show to be dangerous for the economy. It has harmful affect on society. This generates disturbance and unforgiving attitude. It also increment in the crimes. **Poor governance:** Due to bad governance, government fails to manage the law and order conditions. When persons set themselves in front of institutions, they situate a bad

Poverty condition in Pakistan: According to Pakistan Bureau of Statistics analysis, Poverty has increased by

about 30% to 40% over the past decade. This means that 40 percent of the population earn their living below the poverty line. In such a state of their basic needs of depressed life, education and proper medicine turn away from them.

- They are forced to bear thinking only about poverty and unemployment, parents rather than children to school, as far as children. They do this to support their families and use them as winning hands from an early age.
- • As per UNDP report, 65.5% of the population earn less than $ 2 per day in Pakistan.
- • According World Bank statistics 2014, due to the global economic downturn, the proportion of poverty in particular increases in US and European countries are millions of people across the globe pushing deeper into poverty. Nearly 40% of the 107 countries most vulnerable to developing poverty. Pakistan among the 43 countries with the highest risk of poverty.
- • ADB report, poverty spreads in Pakistan due to population growth, internal situation in Pakistan, lag in agriculture, uneven distribution of incomes, cost challenges and rising prices of services Increase in unproductive activities.
- According to Pakistan's Planning Commission (2011), poverty rate has increased 37.5 percent in the last three years. While in 2007 there were 35.5 million people living below the poverty line but in 2010 their number increased to over 64 million.

Objective of the Study: The main focus of this study is to examine the impact of foreign aid (foreign grants, foreign loans) on poverty in Pakistan.

Sub objective include;

- To examine the association between foreign grants and per capita income.
- To determine the effect of foreign loans on per capita income.
- To investigate the effect of literacy on per capita income.
- To find out the impact of unemployment on per capita income.
- To examine the effect of industrialization on per capita income.

Significance of the Study: It is generally consider that the developing countries like Pakistan are dealing with many problems including scarcity, unemployment, lack of human capital, trade and environmental deprivation etc. These problems occur mostly due to the lack of natural and economic research as in case of developing counties. So to fulfill their economic and natural problems developing countries take aid to the developed countries. But the main problem is that in spite of taking vast amount of aid, developing countries like Pakistan are unable to encourage their economic growth and living standard of people. Therefore this study helps us to measure the impact of aid on poverty. After reviewing the relevant literature the gap we found is that the most studies have done research on examined the effect of foreign aid on poverty by using health and education as proxy but in our research we explore the impact of foreign aid on poverty in Pakistan by using per capita income because it shows the living standard of the people rather than education and health.

2. 2. Literature Review

Alesina and Dollar (1998) explored the outline of distribution of aid to recipient countries. They used bilateral aid data and different variables i.e. democracy, population, colonial status, good policy and some other variables. They got result that political and strategic considerations are more essential for aid giving countries. They said that there are three big donors U.S, Japan and France, they give aid due to voting outline and past colonies. These countries aid distribution may be good in supporting strategic interest but bilateral aid has negative relation with poverty, democracy and good policy. On the other hand, they found FDI responded to economic inducement than political and strategic considerations

Collier and Dollar (2000) explained the association between aid and policy reforms and also explained that poverty will be reduced round about 2015. They said efficient aid increased poverty reduction in developing countries. They construct a model to check the impact of aid on policy reforms. They found a direct relation of aid with good policy. Because aid increases good results in the presence of good policy, so those countries that have good policy their trends of growth rate and poverty reduction will increased due to the more aid.

Gomanee and Morrissey (2002) examined direct and indirect effects of aid on poverty. They explained direct

way is this if aid directly affects poor and indirect way is this if aid effects public spending on social services. They used pool paneled data from 1980 to 1998 and to obtain coefficient on aid variable, they utilize residual generated regression. They constructed a random effect model in finding of aid and poverty relation. They found that aid has positive relation with poverty through public spending on social services.

Saunders (2002) investigates the effects of unemployment on funds and welfare programs by measuring poverty and inequality. He explored the relationship of unemployment and poverty by using the estimates of 1970s. He measured the poverty and unemployment by income and labor force status. He found that unemployment increase poverty rates and also create inequality in communities in which unemployed people and their families live. He also gave some suggestions for enhancing the employment generation opportunities.

Starrin (2002) explored the position of unemployed people and social welfare recipients. These two groups are mostly said to be in a disadvantaged position and face degrading behavior from the other members of the society. He described the problems of these two groups. He indicates that unemployed and social recipient people felt some of shame due to the behavior of employed people. This have the negative effect on the position of these two groups and adverse the poverty situation.

Tavares (2003) found that foreign aid significantly reduces corruption. Because the aid given with conditions may control diplomacy of the recipient countries and if aid raises the public employees' salaries, the contribution of corruption may be decreased. Defina (2004) found that unemployment has insignificant impact on poverty rates. But on the other hand real per capita income has strong positive impact on poverty rates for all population sub-groups.

Masuad and Yontcheva (2005) used random effects model and least square estimation in finding the effect of aid on infant mortality. And they had draw result that the countries in which infant mortality is higher got higher NGOs aid and less bilateral aid. In case of illiteracy they found result there was less significant impact of NGOs and bilateral aid. They also had drawn the result that foreign aid has no effect on

government's efforts in promoting two human development indicators.

Abiola and Olofin (2008) found that food supply, multilateral aid and growth rate have positive relation with rural development except FDI. They originated that total grant aid and spending on education have negative relation with rural development, life expectancy rate and per capita income. They also found that spending on health, growth rate and food supply have positive relation with per capita income except FDI, multilateral aid, spending on education and total grant aid but multilateral aid, and FDI have positive relation with life expectancy rate. They concluded, multilateral aid, spending on health and education, food supply are the basic determinants of poverty. Oduor and Khainga (2009) found that ODA payment has effective impact only on poorest of poor, not on those people who live below poverty line. And they also found that the implementation of Paris assertion has been felt by the poorest of the poor.

Ali and Nishat have empirically explained the impact of foreign inflows on poverty reduction in Pakistan. For this, they used health and education and some other indicators. They used time series data from 1972 to 2008 and apply ARDL approach. They created positive relation of foreign inflows with poverty and also with infant mortality through indirect channel. They established positive relation of inflow with female enrollment. They found, that foreign aid is the basic component of foreign inflow, which increased poverty and infant mortality in Pakistan and created positive relation of inflow with poverty. And they also found that, if foreign aid increased then female and total enrollment are also increased. They got result that foreign aid has significant impact on poverty but other two components FDI, remittances have insignificant impact on poverty.

Shirazi, Mannap and Ali determined the effectiveness of foreign aid and human development. They used five annual time series data and take from Economic Survey of Pakistan, Annual Statistics, World Bank, UNESCO and UNESCAP. They used vector error correction model, Granger theorem and Johansen co integration test to determine the relation between foreign aid, human development, life expectancy, ODA and economic. They got result Granger causality between GI and ODA and unidirectional causality of education

index, life expectancy and human development from ODA.

Budiantara et al. (2011) described the relation of unemployment and poverty in Indonesia. They used spline non para-metric model to estimate the relation of unemployment and poverty. They obtained spline estimator by using bayessian approach. They show the relationship of unemployment and poverty in the form of quadratic model. Results shows poverty rates increases in the quadratic curves when the unemployment rates is less than 3.87. When the unemployment is between 3.87 and 4.24 than poverty rates will decline. When the unemployment reached at 4.24, poverty rate decline but at the very low rate.

3. **Methodology and Data Analysis:**

Includes study methodology problem statement, hypothesis testing, research questions, target, sampling procedure, sample size, data collection process, specification model operational definition Of the variables involved in the method of analysis and estimation.

Statement of the problem: Generally consider that developing countries faces many problems as well as scarcity, idleness, illiteracy, lack of human capital, etc, these all troubles occur generally due to the lack of natural and economic research as in case of emergent counties. So to fulfill their economic and natural problems developing countries take aid to the developed countries. But the main problem is that in spite of taking vast amount of aid, developing countries like Pakistan are unable to encourage their economic growth and living standard of people. So this reason induces me to examine the impact of foreign aid (foreign grants, foreign loans) on poverty in Pakistan.

Research Questions:

• What is the impact of foreign grants on per capita income?
• What is the impact of foreign loans on per capita income?

Hypothesis: The hypothesis is a theoretical clarification of the behavior of phenomena, situation and problem which can be tested against the facts.

Now we check our hypothesis whether foreign aid has positive impact or nor on poverty in Pakistan.

This can be checked by making two different hypothesis.

Hypothesis I:
H_0: Foreign loans have negative impact on per capita income.
H_1: Foreign loans have positive impact on per capita income.

Hypothesis II:
H_0: Foreign grants have negative impact on per capita income.
H_1: Foreign grants have positive impact on per capita income.

Data and Sample Size: This present study uses six variables, data on foreign loans, foreign grants are obtained from handbook of statistics or annual report of state bank of Pakistan while data on industrialization and literacy are obtained from World Development Indicators and data on unemployment are obtained from economic survey of Pakistan. The above explain data sources have been selected because they are the most authentic one and mostly used by every researcher. researcher used secondary data from 1986 to 2015 to analyze the impact of foreign aid on poverty in Pakistan and numbers of observations are 30.

Model Specification: This involves identifying the most important variable that is believed to affect the dependent variable. We will use OLS and multiple linear regression models to analyze the results. The per capita income is the dependent variable. Foreign grants, foreign loans, literacy rate, industrialization and unemployment are independent variables.

The regression model is:

Per capita income = f (foreign grants, foreign loans, literacy rate, industrialization,
            unemployment)

Pci = f (foreign grants, foreign loans, lit, inds, un)
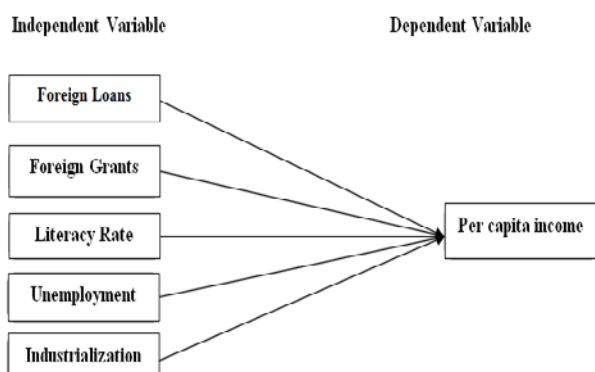
Operational definitions of the variables:

Pci = Per capita income is used as proxy of poverty.

Grants = Foreign aid is measured by foreign grants.

Loans = Foreign aid is measured by foreign loans.

Inds = Industrialization is measured by manufacturing

Relationship Among the Variables:

Independent Variable   Dependent Variable

Foreign Grants & Foreign Loans: In this study, we have combined discussed both foreign loans and foreign grants and analyzed its impact on per capita income. Foreign aid usually comprises of foreign grants and foreign loans (debt). Abiola and Olofin, (2008) argue that foreign grant has negative relation with per capita income. Masud et al, (2005) explained some major points of view depute from the foreign aid efficacy research. 1) Aid is frequently incorrectly placed (specified to wrong recipients), 2) Foreign aid is not correctly used in the recipients and 3) Gross domestic product is not the accurate estimator for foreign aid efficacy. The aid ineffectiveness is directly linked to the improper utilization (Kraay et al, 2005).

Literacy: By providing quality of education a country can improve their economy, personal growth and income. According to Dzingai Mutumbuka, (2004) Education and literacy offer to break out poverty through directly contributing to growth and by increasing fairness and social justice which, in turn, brings about solidness and improves the investment climate. So if people get good education their productivity will be higher than the previous, and will make possible to get more income.
Channel of education with per capita income:

Good education **-->** Employment **-->** Generate income
Improved living standard

The above drawn figure shows the relation between education and per capita income. The above figure starts from the good education which shows that there

value added current US $.

is a strong relation between education and per capita income.

Social Benefits: Literacy can be helpful in people's achievement of a choice of capabilities such as maintaining good health and life expectancy, controlling reproductive behavior. Hence social benefits increased life expectancy and better children's health.

Economic Benefits: The economic output of education is widely noted, especially in terms of increased revenue and economic growth. Education is exposed on several occasions that an important determinant of income of the person. One study examined the relationship between literacy and economic growth and concluded that increasing investments or funds to increase the educational potential GDP and have a positive effect on per capita income.

Political Benefits: The moral or physical power of literacy can interpret into improved political contribution and add to the quality of civic policies and democracy. Hannum and Buchmann (2003) argue that the educated people are more probable to vote and have tolerant behavior and have self-governing values. So there is a connection between education and political involvement.

Foreign Aid (Foreign Loans & Foreign Grants), Literacy: Anwar and Aman, (2010) attempted to examine sector specific aid (loans & grants) and total aid (loans & grants) effects on literacy rate in long run and in short run and found that the sector specific aid (loans & grants) and total foreign aid (loans & grants) in long run for education have positive relation with literacy rate. Malik, (2007) concluded in Pakistan over the past two decades even with some successes, generally poor performance of the education sector does not provide clear evidence for aid's beneficial effects. Asiedu and Nandwa (2007) argue that foreign aid in primary education improves the development in low income countries but foreign aid in post-primary education has insignificant effect.

Foreign Loans, Per Capita Income: Ahmed and Shakur (2011) found the relationship of foreign loans and economic growth. They argue that the main indicator behind the low per capita income is the

foreign loans. Economic growth refers to sustained increase in gdp per capita of a country with a view to reducing poverty, inequality and unemployment (Todaro, 1982).

Unemployment: Saunders (2002) explained unemployment increase poverty rates and decrease per capita income and also creates inequality in communities in which unemployed people and their families live. He also gives some suggestions for enhancing the employment generation opportunities. Defina (2004) find the impact of unemployment on poverty through the distribution of income among the members of the society and found that unemployment has insignificant impact on poverty rates. According the World Bank, poverty implies economic condition where people are incapable to maintain the minimum standard of living. Unemployment has the following effects in a society.

- Unemployment causes sinking, dissatisfaction, anxiety, and many other indifferent emotional states. It is generally observed that the mind status of unemployed people is lesser than the employed people.
- Unemployment generally makes our society poor and also stops the creative power. Due to this People can't give good education and health checking facility for their children. People who are unemployed can't participate in their intellectual activities. This entire means they are completely out from the society. Unemployment has negative impact on joint relations in the family and society.
- Lacks of earnings have a great shock on overall family. Due to this people cannot add with friends at social, sporting and intellectual events. People become isolated; adults get upset and can have serious physical and psychological troubles. And the most risky part is that people without income can't assure their basic need, that's why some of them engage in crime.

Industrialization: Industry is one of the essential sectors and makes the main part of the economy of the country. The countries which were formerly relying only on agriculture encouraged their industrial sector. This change from agricultural to industrial sector has paid the price to these countries. Pakistan faces political instability, lack of capital, communication, infrastructure, technical knowledge and energy. These are the constraints in the development of industrialization and causes of rising poverty in Pakistan.

Estimation: Here is research checked the stationarity of the variables. Surprisingly all variables become stationary at level. That's why this model is allows Ordinary Least Square method for data analysis. In this research researcher used OLS and estimate the regression analysis, standard error of estimate, T- test, F- test and colliniarity test.

Estimation of the Data.
Table

Variables	Coefficients	Std. Error	t-statistics	Prob.
C	-12849.02	5158.183	-2.490997	0.0201
Grants	9.025040	5.381271	1.677121	0.1065
Inds	1.36E-06	2.63E-07	5.181869	0.0000
Lit	-51.36930	256.5248	-0.200251	0.8430
Loans	-3.931740	1.547326	-2.540990	0.0179
Un	-3578.018	986.6568	3.626405	0.0013

Six variables are used in our present study. Per capita income (pci) is the dependent variable and foreign loans, foreign grants; literacy rate (lit), industrialization (inds) and unemployment (un) are the independent variables. We used time series data from the period 1981 – 2010 and the total numbers of observations are 30.

Individual Coefficients and its Significant: Above table shows individual coefficient results of regression analysis. First column shows the variables that are used; second column shows the standardized value of coefficients, third column shows the estimated standard errors of the regression coefficients and fourth column shows t test value and last column shows the level of significance of computed coefficient.

B_1 is the coefficient of grants and its value is 9.02, and has positive sign. It shows that increases in grants will increase per capita income. Its standard error is 5.38, which shows the degree of deviation of the independent variables about the regression line. The "t" is the test of statistic and the value of t for B_1 is 1.67. It is significant at 0.10 levels. So we accept the alternative hypothesis that is foreign grants have

positive impact on per capita income. B_2 is the coefficient of industrialization and it has positive value which shows that increases in industrialization will increase per capita income. Its standard error is 2.36 and its t test value is 5.18. It is highly significant at 0.000 levels. B_3 is the coefficient of literacy and it has negative value which shows that increase in literacy will decrease per capita income because of statistically insignificant. Its standard error is 256.52 and its t test value is -0.20. It is insignificant at 0.84 levels. B_4 is the coefficient of foreign loans and has negative value. It shows that increase in loans will decrease per capita income. Its standard error is 1.54 and its t test value is -2.54. It is significant at 0.017 levels. So we accept the null hypothesis i.e. foreign loans have negative impact on per capita income. B_5 is the coefficient of unemployment with negative which shows that increase in unemployment will decrease per capita income. Its standard error is 986.65, and its t test value is 3.62. It is highly significant at 0.001 levels.

4. Conclusion:

This study determines the impact of foreign aid on poverty in Pakistan by using time series data from 1981-2010. To measure poverty we use per capita income and to measure foreign aid we use grants and foreign loans. The results of this study envisaged that foreign aid, specifically foreign loans, have negatively related with per capita income. This is because of conditional loaning. It means that foreign loans actually increased poverty in Pakistan.

The results indicate that unemployment decreases per capita income in Pakistan and due to it poverty increased in Pakistan. In Pakistan unemployment occurs due to lack of quality education, high prices, over population and low exports, these factors causes to generate poverty and also causes its positive relation with unemployment. Previously in this study, the relationship of foreign loans is shown to be positively with poverty; hence an attempt to reduce poverty and increase per capita income through foreign aid specifically foreign loans under current circumstances would not only increase poverty but also increase unemployment and debt.

The empirical finding indicates that industrialization has positively related with per capita income, which shows that industrialization really decreased poverty in Pakistan. But in current scenario industrialization destroyed due to politically instability which has led to unsteadiness of policies. Limited market, lack of communication, lack of essential infrastructure, lack of technical minded workers and not least but last economic constraint by donor's countries also cause of decline in industrialization.

Another interesting finding of this study is the negative impact of literacy on per capita income. The impact could be due to unemployment because many literate persons are without job and due to this per capita income decreases.

The other result shows that grants have positive relation with per capita income. It indicates that grants actually decreased poverty in Pakistan. This is why? , because grants are not repayable or have no debt burden, it is a gift or free relief of one country to other country. So it increases per capita income of people of Pakistan.

So the inflow of foreign aid specifically foreign loans is rather continuous and increasing with time but their results are not as beneficial as they should be.

Policy Recommendation:

Followings are the suggestions and recommendations:

- The conditional loaning should be discouraged.
- Loans should be disbursed according to the performance and need of any sector.
- Aid should not be like dead aid, it should be like investment.
- Audits of NGO'S sector should be compulsory.
- Education plays important role in the economy. Government should give more concern in this sector. Government must be increase quality of education and reduced expensive education because poor people cannot afford it.
- Policies should be exactingly implemented.
- Soft loans should be given to industrialists on easy installments, so as they could run industries easily.
- New technical institutions should be recognized for the guidance of the labor and equip them with the modern techniques being used in the industry.

- Controlling of inflation may be good effect on the income of people. They may be able to fulfill the basic necessities of their families.
- Developing investment in friendly environment.
- Removal of radicalism and feudalism.
- Equal distribution of resources.
- Developing work should be carrying on whole year because it generates income of population.

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