

Does financial aid help or harm developing countries: Case of Albania

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Abstract. Development aid is a financial aid given by governments, NGOs, global and regional unions, or private entities to support the development of developing countries, as a consequence also of Albania as one of them. Its main reason is decreasing poverty and encouraging development. Many literatures reveal evidences of the impact these financial aids have on the economic growth of a country. This paper creates a link between the research done and the practice by making a detailed description of the phenomena and making clear how the effects are derived. It further analyzes the economic development of Albania in terms of net income during the last 30 years, and the corresponding financial aid allocation for each year. Starting with the interpretation of the financial aid amount allocated each year; this research paper also extends the information regarding the fields of economy where this aid is invested. The descriptive statistics shows that financial aid has noticeably increased from year to year and its impact on the economy as well.

Keywords: financial aid, poverty, development, developing countries, regression.

1 Introduction

Financial aid is money, equipment, or services that are provided for people, countries or organizations that need them but cannot provide them for themselves (Cobuild). Since the world varies so much, each day in each place we face up with different realities. As long as there are wealthy nations, there are also poor and developing countries which cohabitate under the planet. Therefore the world order enhances the collaboration between these countries in a way that reach countries help the developing ones, meanwhile such an action is affected by many other aims and expected or unexpected impacts. On behalf of this reality, many World Unions and Organizations are created since the end of world war second. They develop different ways through which aid can be conducted, which lead to different results and different target groups who directly feel these positive or negative impacts. Many times this impact turns to be negative and even harm the economy of the developing country on the assumption that the situation is very bad and the help does not reach each territory and circumstance. The danger is that the money can be misused so badly under the financial aid justification, and this is a situation which leads to the no development and no improvement of the developing country that deeply needs the help. The effects and reasons of such policies are explained in details below.

This research paper has as a special focus the financial aid allocated to Albania for the last 30 years, along with the net income for the same years, as a dependent variable of the regression model analysis conducted. The range of donators to Albania, from USA to EU and more, is also listed and explained meanwhile the specific areas of investment are mentioned as well. Despite the alternative impact

financial aid may have on different countries and societies, the regression model analysis revealed a significant positive relationship between financial aid and net income in Albania.

2 Literature Review

Many recent literatures regarding the target and impact of financial aid have a special focus on Albania as one of the potential countries who deeply aspires development and integration.

McGillivray (2005) found that when defining whether developing or financial aid is enhancing the opportunities for further development of a country, internal and external factors as well as the background of the country should highly be considered. Thus, African countries, has a positive reaction on financial aid since it is one of the main sources of the economy. Meanwhile, many Pacific countries convey a negative relationship of financial aid with growth mainly because of bad management of financial aid received and the high terms of corruption on these countries. When coming to western developing countries, the positive relationship aid and growth have had until now based on data analysis and economic models is admitted, and the trust for an even stronger positive relationship in the future is very strong.

On the other hand, Brautigam & Knack (2004) on the conducted study focus on the negative impact financial aid may have leading to the awakening of the financial institutions and increase dependence on financial aid agencies. These reality, is one of the main reasons why African countries despite the large financial aid assisted each year still remain the poorest and less developed one, financial institutions are not being developed, are just becoming more and more dependent from financial aid agencies.

Bojceva, Cabuleva and Temelcov (2011) point out that financial assistance is one of the main aims of European Union for Western Developing Countries since this union has assisted with different kinds of financial aids (ISPA, PHARE, CRADS and recently with IPA) which have fostered social and economic development for Albania.

Bushati (2008) stresses the importance of the aid allocated to Albania while focusing on the right niche these money should be invested and how much it has been like that until now.

Ekanayake and Chatra are very flexible regarding the answer of impact, whether it is positive or negative. On the time series analysis conducted they found that depending on the variables you choose the results differ. Thus, it often happens to have a negative impact, at the same time when the positive impact is present especially in Western Balkan developing countries.

Karras (2006) analyses the correlation between foreign aid and GDP in 71 financial aid receiving countries, and concludes that economic growth is positive and significant in terms of the impact of financial aid.

3 The Impact of Development Aid

One of the main reasons of giving aid is altruism, which can be considered as an ethical principle holding that every individual is morally obliged to help or benefit others (Rusell, 2000). Help, is a

moral obligation for each of us, but is a duty first of all for the wealthy governments and the strategies they define. Apart from the humanitarian and emergency needs, as well as moral and ethical reasons that lead different entities to give help and financial aid, we now come to the point to mention the special personal interest that encourages these entities to develop such a relationship with developing countries. The financial aid they give, defines the interference and intervention in national governmental level of aid givers to aid takers. At a glance, everybody would think that donors give aid for the only reason of help. Actually, that is what every aid giver states when giving a developing aid. But realities change a little bit, and as many critics and analysts state, donors generally have their own interest when giving aid (Ridell, 2008). Actually, to be fair to them and on behalf of reality, we should see the 2 sides of the coin. By doing this, we come up to a gain-gain reality, where the reason that leads to give aid is the mutual profit of both parties of this “transaction”.

Based on Degnbol-Martinussen and Endberg-Pedersen the motives that lead to give development aid are: 1) economic motives, 2) motives concerning national security, 3) environmental motives, 4) moral and humanitarian motives (Engberg-Pedersen, 2003).

But we should always bear in mind that political interest, are the oldest reasons that encourage governments to give financial aid. As history has shown, the reasons behind it are mainly because of an expected increase in national security as well as empowerment and increase of the impact on these nations. Thus, as many analysts pretend and as it is generally believed, development aid is directed to the poor countries the moment they satisfy the donor’s interests and goals. “A lot of investment in developing countries comes in the form of loans instead of grants” (Thirlwall, 1994). The Thirlwall statement clearly expresses once again, the idea that the first reason of a government development aid, in all the different forms it may take; grants or loan, is firstly on the donor’s own interest and benefit. The lucky case is when this benefit is mutual.

As Peter Bauer has said, development aid is an excellent method for transferring money from poor people in rich countries to rich people in poor countries.

From this statement, we can easily understand that what randomly happens with financial aid is that the money of taxpayers of wealthy countries goes unfortunately many times to the rich people of poor countries, in a way that nobody becomes better off apart the ones that already were, and had the power and wealth, as it is the African case. We live in an epoch where many NGO and governmental structures apply numerous policies to the third world and especially to the developing countries meanwhile the poverty remains on the same levels. The integration of the rural areas on the impact of development aid is a big problem. Despite the many attempts of donors to encourage the economic development of the developing countries through grants and the direct involvement of the society in the economy, no real effect is felt in the cases when the rural areas are not involved in the project. For the cases of non direct involvement, many social and economic studies have supported the idea that financial aid does not have an impact on the development of a country. Negative side effects of aid can include an unbalanced appreciation of the currency, increasing corruption, and adverse political effects such as postponements of necessary economic and democratic reforms (Aid Effectiveness and Governance: The Good, the Bad and the Ugly, 2009).

As for the Western Balkan countries, thanks to the prosper development of the recent years, the implementation of Eu policies, and especially the efficient monitoring of the European Union itself regarding the integration policies to these countries, the rules have been more tough and the seriosity of financial aid management higher. As a consequence the impact has resulted to be positive.

4 Case of Albania

As from the year 2005 the external assistance in Albania is being monitored by the government. The Department of Strategy and Donor Coordination (DSDC) along with the IPA commission are the official bodies who manage the foreign financial aid for Albania. The four main donors in Albania, conducting the most cases of the recent year are: European Commission (EC), Organization for Security and Co-operation in Europe (OSCE), United Nations Development Program (UNDP) and World Bank (External Assistance in Albania).

There are different private and public American entities which have attributed for years large dollar amounts to Albania. The first American institutions that have been helping Albania in different areas for a long time are: USAID, UNICEF (Turnoff & Nowels, 2004)

As for European Union financial assistance, it has been realized that the more Albania is integrated on the union policies and regulations the larger is the financial aid it receives thanks to the many Western Balkan developing countries policies EU has on special focus the recent years. The latest EU financial assistance is Instrument for Pre-accession Assistance (IPA) which has been active from 2007 until now, and will still operate during the whole year 2013. Meanwhile, the previous year's ISPA, PHARE, and CARDS programs have been the accelerators of the Albanian economy, and have contributed for the development of it.

Based on official data the amount allocated to Albania through the IPA program is 94.5 million Euros. These money are being invested in four main different sectors: Transport, Justice and Home Affairs, Environment and Social Development (Albania Financial Assistance). But financial aid allocated to Albania originates years ago, with data starting from 1980s. The latest official aid received in Albania was \$ 337830000 for the year 2010. Over the last 30 years, the amount of aid has fluctuated from 1359000 in 1882 to 488150000 in 1999 (Albania- official aid received).

4.1 Methodology and Data

Studying the effects of financial aid in the economy of a country needs not only theoretical concepts, but what is more important; it should be seen on an empirical framework as well. Thus, to have an exact idea concerning the financial aid effect allocated to Albania and its impact on the economy, an econometric study is the most appropriate. The data taken include information for the last 30 years, from the year 1980 to the year 2009, a total number of observations equal to 30. There are two variables for this econometric model-regression analysis, the independent variable and the dependent one. The dependent variable (Y) is Net Income of Albania for the last 30 years. This variable is considered as the dependent one because the purpose of the econometric study (regression analysis) is to express in real terms the effect that the financial aid allocated to Albania have on the national net income of the last 30 years. As a logical consequence, the independent variable is represented by the financial aid amount allocated each year to Albania for the time zone defined above. These variables are classified this way as they are considered to affect one another in a positive relationship. In other words, as the econometric model results reveal as well, financial aid affects in a positive way net income in Albania.

4.2 The Regression Model

$$Y = \beta_0 + \beta_1 * Fina + \mu \tag{1}$$

Where:

Y = Net Income

Fina = Financial Aid

μ = Stochastic Error

β_0 = The intercept

The hypothesis:

H₀: The Financial Aid does not have a significant impact on the Net Income of Albania

H₁: H₀ is not true

As a beginning, the intercept value B₀ shows the value of Net Income of Albania if all other variables are held constant, thus it does not have a major importance, since this econometric model is concerned for the impact of financial aid on net income.

Dependent Variable: Y
 Method: Least Squares
 Sample (adjusted): 1980 2009
 Included observations: 30 after adjustments
 Y=C(1)+C(2)*FINA

	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	6927968.	20388937	0.339791	0.7366
C(2)	0.032466	0.079817	4.067371	0.0004
R-squared	0.571401	Mean dependent var		73051137
Adjusted R-squared	0.548951	S.D. dependent var		83530403
S.E. of regression	67398675	Akaike info criterion		38.95449
Sum squared resid	1.27E+17	Schwarz criterion		39.04790
Log likelihood	-582.3173	Hannan-Quinn criter.		38.98437
F-statistic	16.54351	Durbin-Watson stat		1.059104
Prob(F-statistic)	0.000351			

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probability value of the independent variable is smaller than 0.05, it actually is 0.0004; we can say that the relationship between the two variables is significant. Furthermore, the positive value of the coefficient C(2) conveys a positive significant relationship between the two variables. Thus the equation model would be:

$$Y = 6.9 * 10^7 + 0.032466 * Fina \tag{2}$$

From these estimations, it results that a 1 % increase in financial aid increases net income by 3.2 %. This is a very rational result, which shows that financial aid has an impact on net income, but at the same time the small value of the result let us understand that there are also other factors, not listed and mentioned on this estimation since they are not on the focus of this case, which also have a very strong effect on net income, making us realize that the value of net income is affected by several internal and external factors which affect at the same time.

The R-squared value of 0.571401 means that 57% of the variation among the variables is explained by the equation. This leads to the rejection of null hypothesis. Alternative 1 is accepted. The estimation model proved that Financial Aid has a significant impact on the Net Income of Albania.

This is a very important result which shows the importance of financial aid in terms of economic development and prosperity, and should be considered as an impulse for giving priority to the right management of financial aid, as one of the crucial points of the economy, which still needs to be improved in terms of its efficiency.

5 Conclusions

The different types of aid, from private to public ones, from short term to long term ones loudly express a specific reason: give financial assistance and help. Under this reason, unreasonable cases may happen.

The ideal case; the aid goes to the right target group in the right time, so that the impact is always positive does not happen always. Sometimes, this development aid is misused in the interest of the donors' side being thus the reason of a very undesirable situation where the country in need did not take the needed help, and the impact of the aid resulted negative.

The other side of the coin lists the histories of success regarding development aid. These are the Western Balkan Developing countries, which while aspiring EU integration, are much more encouraged to follow accurate procedures and policies regarding the use of the financial aid, especially the European one.

Albania, one of the typical Western Balkan countries, is in the right path regarding this topic. As many analysts and researchers have stated, and as the regression analysis model results showed financial aid has a positive impact in Albania, in terms of Net Income for the last 30 years. 1 % increase in Financial Aid, would lead to 3.2% increase in net income, showing the significant relationship between these two variables.

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