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The effect of foreign aids on economic growth of Afghanistan during the years (2002 to 2018)

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Abstract

As per the international economics theories, one of the challenges of developing countries is lack of capital and financial resources and it should be eliminated by every possible way. Afghanistan is also one of these countries from long before more or less this country needs foreign aid specially this dependency after 2001 has been increased. Oral promises of the donors were more but Afghanistan till end of 2018 has received almost 119 billion dollars cash. This aid has effect on economic growth of the country. In this article the effect of foreign aids on economic growth of Afghanistan has been discussed by using the library research method. The data of this research is for a period of 17 years from (2002 to 2018) has been downloaded from central statistics website. The data has been analyzed by using E-views software with the help of OLS model. Several tests on data have been done, the research results during the years show a positive relation. If the foreign aids change 1%, GDP will change 0.72% also on the other hand if we assume the other factors which have an effect on economic growth of the country to be stable; it shows that foreign aids only can provide 0.25% of economic growth.

Keywords: Foreign aids, economic growth, annual reports, conference and Afghanistan.

Introductions

Foreign aids are factors for improving the economic foundation of a country. (13: 3) [13]. They are financial, professional and goods that aims to improve economic development, level of life and are presented as free aids and friendly loans (14: 498). According to Rosto theories foreign aids are important in the stage of rising and situations before rising for the development of the third world. As there should be minimum income to have sustainable growth while the new dependency school believes that donors are interested in their own profits. (13: 3) [13]. The success of Marshal Model in the reconstruction of Europe economy induced the liberalized Asian countries and American Latin to cope with shortage of domestic saving they should pay attention to foreign investments. Recently Afghanistan is also from those countries which are benefitted from foreign aids. (4: 20) [4].

Afghanistan due to its important geographical location has received assistance from several countries. Especially after 11th September's incidence forming the temporary government as per the Bon agreement from 2001 to 2017, 15 international meetings organized. Nearly 70 countries and international organizations promised billions dollars for the development and reconstruction of Afghanistan and the aim of these cooperation were reinforcing the human values, fighting against terrorism, fighting against narcotics, security, reconstruction of infrastructure, economic growth and development (1: 198).

This article wants to prove that:

1. How much is the relationship of foreign aids and economic growth?
2. In case of having relationship how much will be the impacts of foreign aids on economic growth of Afghanistan for a period of 17 years?

Literature review

1. Karim imami and Najma Azad has a study on effect of foreign aids on growth of per capita income in selected developing countries from 3 regions of Asia, Africa and Latin America using 1983 to 2010 data. In Islamic Azad University, Tehran branch by using chart method, they come to know that foreign aids have negative impacts on per capita income in selected countries (8: 2) [8].
2. Sayed Jawad Ramyar, Ali Akbar Majidi and Mohammad Mazloom Khorasani had a study on role of foreign aids in economic and social development of Afghanistan in

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1397, published in Islam world research journal no. 13 shows that the relationship between foreign aids and GDP per capita income variables, hope to life, training, surging crowd and human development is meaningful and positive but between foreign aids and security situation improvement variables and decreasing narcotics production, the relationship is meaningless and reported negative on rate of unemployment. Therefore foreign aids is not effective in improving security situation, unemployment situation and decreasing the production of narcotics but resulted in improving the health and people access to training services situation (13: 1) ^[13].

Concept of foreign aids

Foreign aids are categorized into two parts- one is grants and the other is foreign loans. Grants are free while loans are repayable. As per United Nations expression, economic aids include grants, net and long term loans which are paid for supporting civilians.

United Nations accept only economic aids as aids but donor countries consider almost every expense as aids to other countries. (7: 180) ^[7].

In fact foreign aids have become a window for entering the countries receiving the aids and through that first it will affect the economy and then will change the policy of that country to achieve its goals. (9: 45) ^[9].

In fact aid is that payment of an independent country to another country or is a payment by a section of country to another section of the country. In other words foreign aids are tools to support the economy of a country by using the resources of other country. Four categories of factors are effective in the foreign aids; the first factor is the surplus of capital in donor countries. Second factor is the absorption capacity of foreign aids by countries receiving the support. Third factor is lack of natural and human resources and the fourth factor is the reimbursement capacity of countries receiving the foreign aids. (15: 197).

As per the information of Britain testimonial foreign aids history goes back to 18th century. When the Prussia king took into account the friendly payment for helping its foreign military alliances also some European powers in 19-20 centuries by sending foreign aids to its colony, was trying in the first phase to improve the infrastructure of these communities. But the history of foreign aids as of today goes back to after Second World War. The first foreign aid program (Marshal Design) or was the reconstruction program of Europe. This program was for helping European countries in 1948 an amount of 13 billion dollars for a period of 4 years where the countries have seriously suffered from the Second World War. In Afghanistan the first package by the name of foreign aids was handed over to the King in 1857 by the Eastern India Company.

In 20th century when as the result of cold war competition between Soviet Union and USA started the two countries for keeping the influence in Afghanistan and the region have sent their assistance to Afghanistan.

More aids to Afghanistan took place in 1960 decade where almost 40% of the budget was formed through this aids. After 1978 and the dominance of Soviet Union in Afghanistan the western aids to Afghanistan has decreased. In 1996 with reappearance of Taliban the aids has stopped but after 2001 with the formation of new government in the country the assistance became awesome (7: 181) ^[7].

The history of foreign aids in Afghanistan can be

categorized into 3 parts:

1. Before the cold war period (1919-1950): For modernizing the central economy at the time of king Amanullah Khan for increasing the level of economic growth lots of efforts has occurred. Since the domestic income from 18, 18% in 1953 and 7% in 1958 has decreased. The domestic income was not sufficient to fulfill the financial needs and caused national deficit in the country. In order to fulfill the budget deficiency the government tried to receive foreign aids. As the result of foreign aids we can name the construction of Malalai, Lisa-e-Isteqlal and Lisa-e-Habibia schools.
2. Cold war (1960-1990): In 20th century in order to save the country from the pressures of super powers, Prime Minister Sardar Mohammad Dawod Khan demanded financial assistance from the USA and Soviet Union. In 1339 maximum aids took place and almost this amount formed 40% of national budget. From 1950 to 1970, Afghanistan received 50% of the foreign aids from the Soviet Union and 30% from the USA where nearly 160 million dollar was in the form of loan also some financial assistance received from World Bank and Asian Development Bank. In 70s decades the amount of aids Afghanistan received from the Soviet Union was more than 11 billion dollars and the official assistance to Afghanistan has stopped after the government of Dr. Najibullah where this action caused to get the cold war ended in 1992 but humanitarian assistance in low level by some countries through NGOs and United Nations organizations has continued between the years 1992 to 2000 but as the result of lack of precise data regarding assistance in these years we cannot get a result (13: 68).
3. After 11th September incidence (2001 up to now): After Taliban regime Afghanistan was the attention point in the economics history of Afghanistan. The international community for changing Afghanistan into a stable country and keeping the global security again entered Afghanistan. From 1380 to 1395 more than 15 international conferences have been held on Afghanistan. Among this the Bonn conference (2001) in which the formation of government and Tokyo (2002) which was the beginning of Afghanistan reconstruction assistance was more important. Access to a particular number in respect to amount of cooperation is a tough activity. Majority of the aids to Afghanistan was free and the government in the first 10 years have received almost 5/1 billion dollars loan. Majority of the lenders are World Bank, Asian Development Bank, Islamic Development Bank, International Monetary Fund and OPEC. It is mentionable that between the years 1381 to 1391 the countries like China, Denmark, Republic of Czech, Germany, Russia, Saudi Arabia, America and World Bank withdrew from 12.382 billion dollars paid loan. The aids come under four categories: Aids in the form of cash, non-cash aids, aids in the form of weapons and cultural aids. According to the government's report almost 51% of the aids have been spent in the security part. According to Special Inspector General for Afghanistan Reconstruction (SIGAR) report, USA up to 2017 has spent 119.74 billion dollars only for reconstruction of Afghanistan. Summary of these aids are shown in the below table: Ministry of Finance (13:43).

Table 1: Promised aids to Afghanistan in different countries

Table showing amount of promised aids in different conferences to Afghanistan in billion dollars										
Date	2001	2002	2005	2007	2008	2009	2010	2011	2012	Bilateral Assistance
Conference	Tokyo	Berlin	London	Rom	Paris	Chicago	Tokyo	Brussels	Warsaw	
Promised	5.1	5.6	8.7	0.04	14	14	16	15.2	5	56
Main Reference: (Ministry of Finance) from Ramyar Article										

Economic growth

Increase in the quantity of product in a particular period compared to the similar period is called economic growth (10: 13). According to classical economics (1776-1834) economic growth is temporary, by paying attention to employment market and population of the society, technical changes of capital are considered as economic growth motor. They ignore the impact of GDP on existing capital, investment, savings and interest rate. But the new classics have put the previous weak points at the top of their study and expressed that in case of stop of technical changes, growth will change (2: 35) [2]. New classics have started their research about growth with the help of quantitative data after Second World War. They consider the advancement of technology as external factor and capital accumulation as internal factor of growth and production. But new growth theory which is related to the theory of American Pul Rumor and Irish Schumpeter express that in case of existence of profit and competition economic growth

will occur. And economic growth can continue unlimited and they consider growth rate as depends to the ability of individuals for innovation and real interest rate. (12: 62). Resources or factors effective to economic growth which causes increase of production and economic growth can be capital inventory and changes of that available resources and their movements, growth adaptation institutions, technical advancement and business mentality where their composition can be effective for economic growth and economic growth besides of having more effectiveness can have effect on uses of environment, unfair distribution of income and wealth.

Afghanistan Economic Growth: Afghanistan economic growth has its ups and downs, sometimes even we can't trust on that. In an updated report of World Bank the economic growth of Afghanistan has been predicted 3.2% in 2018 in case the security situation doesn't become worse (2 : 35) [2].

The summary of this data has been shown in below table

Table 2: World Bank Website

Table of economic growth rate in Afghanistan between (2003-2018)																	
years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Growth	28,6	9	8.44	1.06	11.18	5.55	13.74	3.61	21.02	8.43	6.11	14.43	1.96	1.31	0.84	2,6	3,2

Aid and growth: From be late of 1950 decade, theories based on role of foreign aids on economic development and growth has been formed. Two cleft model theory is the initial theories that describes the role of foreign aids on economic growth. This theory has been proposed by Chenry and Estot in 1966. They argue that developing countries will remain undeveloped due to savings limitations and foreign currency, insufficient savings, formation of capital in low level and finally will result in low level of internal investment. From other side shortage of currency incomes will also cause limitation of importing capital goods and advanced technology from developed countries to developing countries. Pacha and Taylor have argued that developing countries are facing with financial gap limitations so the responsibility of foreign aids in this theory is supply of additional fund for completing the financial gaps and for improving economic growth in the developing country. Rosto's economic growth theory phases 1960 describes that transfer from lag towards development can cross according to a field from phases that all countries must cross. These phases are traditional society, before rising stage, rising stage, economic maturity and mass consumption stage. Therefore developing countries also can cross by foreign aids from the aforementioned stage to access sustainable economic development (8: 4) [8].

In the last years the foreign debt of developed countries have seriously increased as now the countries like USA, Britain, Germany, France and Netherlands are considered as first world debtors.

The IMF report 2011 shows that for the first time after Second World War foreign debt exceeded to GDP of developed countries from 100%. It seems that study between foreign aid and economic growth has remarkable

importance to all countries (11: 140) [11].

In general there are 3 views for using from the foreign sources. The first view is comprise of theories that considers foreign sources important for growth and economic development, according to scientists this view the developing countries are famous to poor economy from investment point of view, less savings or less investments. While the average gross investments in the developed countries are between 15 to 20% of gross national product. The gross investment rate in developing countries is between 5 to 10%. In fact the developing countries can't afford the financial expenditures relating to depreciation and exchange of capital goods by less savings rate. In addition to mentioned cases because of scientific weakness in developing countries the possibility of accurate use of existing sources is less. At last for such countries foreign sources for reaching ideal economic growth is important. The second view includes theories that believe foreign aids are not inseparable parts of growth and development factors. Professor Bayer writes, in developing countries, foreign aids are not the necessary condition or enough for liberation from poverty. Instead as the necessary conditions for development are available and social and economic projects have been implemented, growth and development is possible without foreign aids. Also if the mentioned condition is not available economic development even with the foreign aids is not possible. The third view is comprises of those theories where foreign aids becomes waste. They don't consider that as enough condition for economic growth but they believe that with good management economic development and growth is possible. This management includes allocation of loans received to production of exporting goods, prevention from waste of

receipts and so on (15: 197).

Regarding effect of foreign debt on economic growth, there are different views like limited liquidity hypothesis, debt threat, debt direct effect and uncertainty hypothesis.

Limited liquidity hypothesis explains: countries having high debt, repayment of debt installments become so difficult that will decrease the funds available for investment.

Debt threat hypothesis shows that high level of current debt make the economic activities worse because it causes increase in additional taxes on products so it changes the savings and investment motivation.

The debt direct effect hypothesis explains that even if the foreign debt installment payment doesn't negatively effect on savings and investment. There is a possibility that product growth directly through reduce of productivity due to adverse changes in combination of investment and uncertainty hypothesis belongs to effect of foreign debt on increase of fluctuating inflation and interest rate that effects on economic activities through creating instability in investment (15: 197).

A theory that considers the effect of quality of foreign debt on growth nonlinear is known as threshold theory. In this theory foreign debt up to a threshold has positive impact on economic growth, after that threshold point more debt has negative impact on economy because there is a possibility that private investments may decrease and resources may go out. i.e. every country by finding threshold of internal economy, they should avoid from more borrowings(11: 140) [11].

Beside other factors of economic mismanagement that not only causes slow economic growth but is also due to serious debt of developing countries. We can search the root of debt crisis in weak policies and economic mismanagement (5: 100).

Research data

The data used in this research is for a period of 17 years which is between the years (2002-2019). The data has been gathered from the yearbook of Directorate of Central Statistics of Afghanistan.

Research model

The objective of current research is showing the effect and relation of foreign aids on economic growth of Afghanistan. Since the data is quantitative we used simple linear regression and ordinary least squares (OLS) model.

$$GDP_{(Growth)} = \alpha + \beta_1(FA) + U_i$$

GDP :In the above model GDP shows growth, name of GDP is as dependent variable, Alpha (α) shows width from

origin, β_1 shows coefficient of independent variable, FA i.e. foreign aid as independent variable and U_i is component of accidental disruption.

Research hypothesis

Foreign aids have effect on economic growth of Afghanistan.

$$H=GDP=FA$$

Diagnostic tests

1. Variance test: As we already mentioned that the variance test is used to show the remained matching variances where their hypothesis is as follows:

Null hypothesis: nonexistence of incompatibility variances between remaining.

Alternative hypothesis: existence of incompatibility variances between remaining.

Table 3: variance test result

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	0.191850	Prob. F(3,12)	0.8999
Obs*R-squared	0.732277	Prob. Chi-Square(3)	0.8656
Scaled explained SS	0.473066	Prob. Chi-Square(3)	0.9248

This test by using Prosh Pegan method shows that the probabilistic value of chi square is 0.9248 and is higher than Alpha value 0.05. So we can't reject the null hypothesis. We conclude that the remaining has incompatibility variances and it shows that we can use Ordinary Least Square (OLS) model in our research.

2. Serial correlation test result: existence or nonexistence of examined serial correlation is necessary in all researches.

Null hypothesis: nonexistence of serial correlation.

Opposite hypothesis: existence of serial correlation.

Table 4: Serial self-correlation test results

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.766835	Prob. F(2,10)	0.4900
Obs*R-squared	2.127572	Prob. Chi-Square(2)	0.3451

The probabilistic value of chi square is 0.345 which is higher that Alpha value 0.05 so nonexistence of serial self-correlation between remaining is accepted which shows good regression.

3. Remaining normality test results:

Null hypothesis: remaining has no normal distribution.

Alternative hypothesis: remaining has normal distribution.

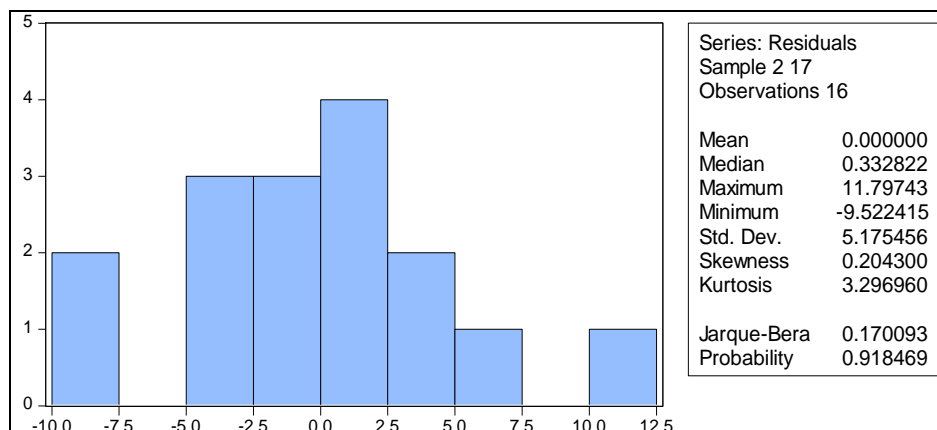


Table 5: Remaining normality test results

Test results show that probabilistic value of Jarque-Bera is 0.17 which is higher than the probabilistic value 0.05 so remaining has normal distribution.

4. Regression stability test: In order to know whether the useable regression has stability or not we use the (CUSUM) test.

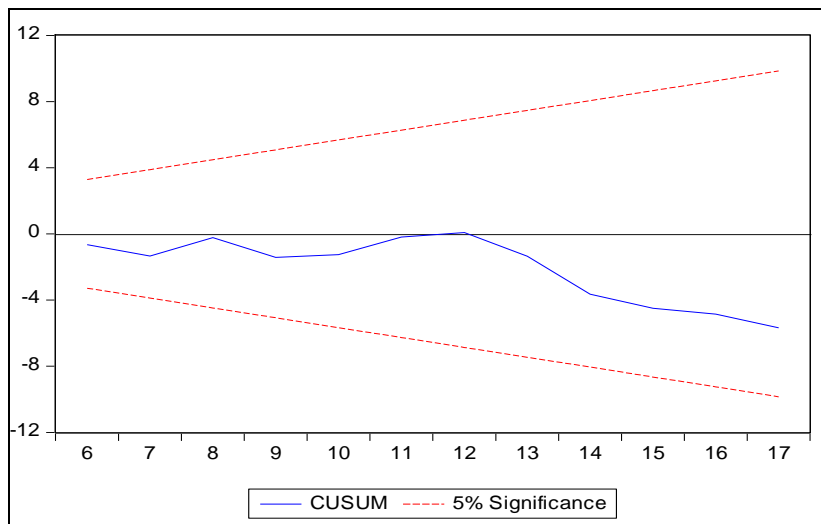


Table 6: CUSUM test

According to the graph we can see that regression line is in the middle showing the regression stability so we can conclude that our regression model has good stability.

Dependent Variable: GROWTH
 Method: Least Squares
 Date: 02/01/20 Time: 17:15
 Sample (adjusted): 2 17
 cluded observations: 16 after adjustments

Research findings results

Table 8: Research findings results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.069480	4.144749	1.223109	0.2448
GROWTH(-1)	0.239881	0.193499	1.239702	0.2388
AID	0.723561	0.528986	1.367825	0.1964
AID(-1)	-0.686051	0.521355	-1.315901	0.2128
R-squared	0.256333	Mean dependent var		7.606250
Adjusted R-squared	0.070417	S.D. dependent var		6.001496
S.E. of regression	5.786336	Akaike info criterion		6.561194
Sum squared resid	401.7802	Schwarz criterion		6.754341
Log likelihood	-48.48955	Hannan-Quinn criter.		6.571084
F-statistic	1.378755	Durbin-Watson stat		2.478376
Prob(F-statistic)	0.296524			

As per the results we got from E-views, the value of Durbin Watson 2.478376 is higher than R^2 showing that this model is good also it indicates that if foreign aids change up to 1%, GDP will change up to 0.72%, on the other hand in case if we assume other affecting factors on economic growth as stable it will show that foreign aids can only explain up to 0.25% of economic growth. Therefore our estimated model is accepted since our probabilistic value i.e. Alpha 0.05 is smaller as the result the null hypothesis is rejected and alternative hypothesis is accepted.

Conclusion

This research is done under the title of effect of foreign aids on economic growth of Afghanistan for the last 17 years. First we discussed on theories, features and meaning of aids and economic growth then by using numbers and figures we analyzed the rate of foreign aids and economic growth of Afghanistan and finally we specified the level of influence of dependent variables (economic growth) from independent variables (foreign aids), which shows a meaningful and stable direct relation also it indicates in case 1% change in

foreign aids growth will change 0.72% and in case the other factors remain stable and existing figures of foreign aids it will describe 25% of economic growth in Afghanistan.

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