

## Foreign aid: history, theories, and facts

*Brian I. Baker*

What drives a country to donate aid to another country? Is it altruism? The expectation of something in return? Both of these? Something else? In “[Donor motives for foreign aid](#)” (Federal Reserve Bank of St. Louis *Review*, July/August 2013), Subhayu Bandyopadhyay and E. Katarina Vermann present a historical review of U.S. and other countries’ foreign aid, together with theories and with empirical facts that mostly support the theories. Overall, the authors find that motives of donating nations have varied over the decades, but two stand out: humanitarianism and strategic interests. Both have existed in different and changing proportions since about World War I, and both still exist today, but the watershed events of September 11, 2001, have focused nations’ efforts on the latter.

The authors begin with an account of which of the world’s regions have received foreign aid from 1960 to 2011. Throughout the entire period, sub-Saharan Africa has consistently received the most aid, and that aid has increased from \$6 billion in 1960 to \$46 billion in 2011 (in constant 2011 dollars). Also, there was a spike in aid to Middle Eastern nations in 2005—a phenomenon associated with the Iraq war—as well as a decided upward trend in aid to countries in south and central Asia, likely because of the “growing involvement of the member nations of the Organisation for Economic Co-operation and Development. . . in addressing security concerns originating from the Indian subcontinent and surrounding areas.”

Next, the focus shifts to which nations have received U.S. foreign aid over the same period. In the 1960s, India received a disproportionate share of U.S. aid, because it was one of the poorest countries at the time. Then, in the 1970s, Israel and Egypt got the lion’s share of U.S. foreign aid, largely because they were partners of the United States in attempting to broker a peace deal in one of the most turbulent regions of the world. Later on, in the early and middle years of the first decade of the 21st century, Iraq was the recipient of large amounts of foreign aid as the United States prosecuted the war.

After their historical review, the authors bring forth a number of theoretical models of donor nations’ motives proposed in the literature on foreign aid. Chief among these models is that of Leonard M. Dudley and Claude Montmarquette (“A model of the supply of bilateral foreign aid,” *American Economic Review*, March 1976), which, apparently, serves as an archetype upon which the other models expand. According to that model, three donor motives play the leading role in decisions involving foreign aid: expectations of gratitude, in the form of support for the donor’s interests; furtherance of the donor’s economic interests, via the vehicle of more trade; and altruistic motives, the desire to raise the standard of living in recipient countries. Dudley and Montmarquette express their model in three equations which together imply that per-capita aid to a nation rises when (1) the value to the donor of giving foreign aid to that nation is high enough, (2) the recipient nation’s per-capita income is low enough, and (3) the recipient nation’s population is low enough.

The authors then present various extensions and elaborations of the Dudley–Montmarquette model before examining the empirical literature on the subject of foreign aid. Chief among the findings from the literature are the following: (1) an increase of one standard deviation in civil or political rights results in an increase of \$29 million in aid to a recipient country, and an increase of one standard deviation in government effectiveness produces an increase of \$54 million (Subhayu Bandyopadhyay and Howard J. Wall, “The determinants of aid in the post–Cold War era,” Federal Reserve Bank of St. Louis *Review*, November/December 2007); (2) ties to former colonies and perceived strategic factors on the part of the donor nation play an important role in the latter’s decisions regarding foreign aid (Alberto Alesina and David Dollar, “Who gives foreign aid to whom and why?” *Journal of Economic Growth*, March 2000); and (3) the levels of foreign aid donated to (nonpermanent) member countries of the United Nation’s Security Council “sharply increase in the year in which a country is elected to the Security Council, remain high throughout the two-year term, and return to their earlier level almost immediately upon completion of the term” (Ilyana Kuziemko and Eric D. Werker, “How much is a seat on the Security Council worth? Foreign aid and bribery at the United Nations,” *Journal of Political Economy*, October 2006).

Authors Bandyopadhyay and Vermann conclude their article with the observation that the altruistic motivation of facilitating the process of development in donor countries’ former colonies “was central in foreign aid flows throughout the 1960s and still remains one of the multiple objectives that determine aid.” However, strategic interests also have been, and still are, relevant, from their importance in buying allegiance from countries during the Cold War to today’s focus on security concerns—a focus brought about by the horrific events of September 11, 2001.