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The Effects of Multilateral and Bilateral Aid on Economic Growth in Pakistan

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ABSTRACT

This research work intends to estimate the effects of bilateral as well as multilateral aid on economic growth in the case of Pakistan. For this purpose, the study has been used annual data from 1985 to 2015. Our dependent variable is economic growth and the model is including Labor Force, Net Gross Capital Formation, Bilateral and Multilateral aid as explanatory variables. The study objective is to find out that either bilateral or multilateral aid effect the country's economic growth. In empirical exercise first use Unit Root test to check for the stationarity of the data, and then the Johnsen Co-integration approach and Error Correction Model have used to estimate long run and short run parameter estimates of the model. Finally, in diagnostic test the LM test for serial correlation and the CUSUM and CUSUM Square test have used to check the parameters stability in model. In results, we found that multilateral and bilateral have negative relationship with the economic growth and their coefficient are (-0.15, -0.33) percent respectively. However, it means that if there is 1% percent increase in the multilateral and bilateral aid it will decrease the economic growth by -0.15% and -0.33% respectively. Similarly, the labor force and Net Capital Formation has positive relationship with dependent variable (economic growth) and their coefficient are (4.52, 0.61) percent respectively. It also means that if there is 1% increase in labor force and Net Gross capital Formation it will enhanced the economic growth by 4.52% and 0.61% respectively.

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Introduction

There are so many debates on the foreign aid especially in the developing nations including Pakistan. However, the Official development assistance (ODA) or foreign aid has been one of the most important economic growth factor throughout the history which accelerate the economic growth in the developing economies (Hee and Lee, 2018). In addition, unfamiliar guide is essentially characterized donation of cash, products, or administrations starting with one country then onto the next. Such donation can be made for a helpful, charitable reason, or to propel the public interests of the giving country. Moreover, unfamiliar guide separated into reciprocal and multilateral, Bilateral guide characterized is typically tied guide (contingent guide) is when beneficiaries should buy items/administrations from the benefactor country. Multilateral guide is generally loosened guide that can be spent in any area of the beneficiary country (Murshed and Khanaum 2012).

However, many experts and economist be certain of that aid complement domestic resources and also supplement domestic savings to fulfill the saving and investment and foreign exchange gap with foreign assistance. Moreover, the aid also provides many opportunities to modernize technologies, have better managerial skills, and also channel to global markets (Chenery & Strout, 1967; Papanek, 1973; Hjertholm et al., 1998). Foreign assistance also includes such as social infrastructure and economic infrastructure. While, social framework mean schooling, water supply and sterilization, all with the plan to work on human turn of events and in the end add to long haul feasible monetary development (Addison and Tarp 2015).

Foreign aid provides additional finance through which the developing countries spend in different sector in the economy. Morrissey (2001) has conducted a study and he argued that there is so many channels through which aid can accelerate the growth such as enhanced human and physical capital also increased to import the capital goods and modern machinery which can further boost the economy. In addition, foreign assistance is necessary and important for the third world nations through which enhanced the investment, to reduce poverty, and for the good governance in the economy (Mustafa and Razak 2012).

In contrast to the above discussion, some experts and scholars has argued foreign assistance dose not have any significant impact on economic performances in the developing country. And emphasizing there is negative relationship between the economic growth and foreign aid of the recipients nations. As kept up with by this view, unfamiliar guide is altogether devoured and use instead of as opposed to supplements homegrown assets. Essentially, it additionally bring up that unfamiliar guide is fundamentally used to import unseemly innovation, twists homegrown pay appropriation and energizes a greater, wasteful and degenerate government in agricultural nations (Griffin and Enos, 1970; Weisskoff, 1972). Moreover, Easterly (2001) reveled that there is no empirical relationships between the economic growth and foreign aid also between aid and investment.

However, many studies defined negative correlation because of so many reasons such as bad economic policies, also there has been a lot of government intervention in which the aid is not working properly and instability of foreign aid flows in the given countries (Levy 1984). Singh (1985) directed a review wherein he express that intercession in the economy produce not a decent effect on financial development and it makes the guide development relationship genuinely inconsequential. Similarly, Burnside and Dollar (2000) revealed the relationship between foreign aid and economic growth in which he claimed that if there is good and sound economic policies in the country who received the foreign aid then there is may affect the economic growth.

Moreover, Wako (2011) argued the there is no evidence that multilateral and bilateral aid on the economic growth. Similarly, Zimbabwe received large amount of foreign aid but still are underdeveloped because they cannot utilize the foreign aid in a good approach to approve the economic development in the economy. Zimbabwe received the foreign aid since 1980 and at that time there was rise in the economic growth in the economy and after that there was decline in the economic growth in 1990. And that decline in the economic growth because the Zimbabwe government cannot control over the macroeconomic policies (Moyo & Mafuso, 2017).

Pakistan remains a developing country and received the foreign aid in the procedure of multilateral and two-sided aid from different countries besides from different institution. There are so many countries that they are received foreign aid and Pakistan is also included in those countries. Pakistan received the large amount aid to enhanced the economic performances and groundwork such as railways, better Health, and also promote the social welfare, education and good environment and to support the Business sector in the economy (javid and Qayyum 2011).

Pakistan depend on the foreign aid since 1950. There are so many fluctuations occurred in the foreign aid and there are so many reason for that fluctuations. (Ghulam Mohey-ud-din 2005) argued that Pakistan neglected three-year foreign aid and received the first aid in 1950. The first aid name was Common Wealth aid the Colombo plan during 1950 and that aid was the project and non-project aid and total

assistance was estimated at $63703 explain in table1. In any case, Pakistan has gotten around US$73.14 billion as foreign aid from 1960 to 2002, yet the advantages of this guide streams have not extended to the entire society, which implies that foreign aid has neglected to work on the monetary conditions in Pakistan (Anwar and Michealowa, 2006).

Table 1: *Aid Disbursement to Pakistan from (1952-2002)*

Disbursed Aid by Type in Millions ($) to Pakistan, during 1952-2002						
		Non project Aid				
plan/year	**project aid**	**Non food**	**Food**	**BOP**	**Relief**	**Total**
1952-55	170	48	119	0	0	337
1956-60	406	244	192	0	0	842
1961-65	1209	420	765	0	0	2394
1966-70	1811	763	469	0	0	3043
1971-78	2543	1299	785	1090	0	5717
1979-83	3363	950	36	531	643	5523
1984-88	4882	791	776	0	734	7183
1989-93	7643	1922	1558	413	545	12081
1994-98	9564	61	1923	1139	61	12748
1999-03	4991	0	502	8307	35	13835
Total	**36582**	**6498**	**7125**	**11480**	**2018**	**63703**

Source: *Pakistan Economic survey*

The last dramatic increased in the foreign aid because of 9/11 events in 2001. Mr. Bush and Mr. Obama was against the terrorism and Pakistan was standing with US to encouraged the peace as well as stability in Afghanistan. Since 1950 the US give a lot of money to Pakistan in the form of aid. US give the aid $30 billion (Epstein & kronstadt 2012).

There are so many research had been done on this issue. However, Mohey-ud-din (2005) argued that in Pakistan there is low level of income, low level of saving, and low level of investment and also the trade deficit in the economy so foreign aid is greatly affect the economic growth and he described there is good relationship between the assistance and economic growth. Similarly, Javid and Qayyum (2011) studied the foreign aid effect on economic growth. They found there is positive relationship between the foreign aid and economic growth. And also they give some policies that if the macroeconomic policies are good in the economy. Azam (2014) have deliberate that the foreign aid is mostly used for the natural disaster in the case of Pakistan and also for education for environment, Health. He argued there is significantly adverse relationship amid the aid and economic progress.

So in the above studies some researcher is said there has been good and positive relationship while other said there is negative relationship with aid. Now there are some gap in these studies which will cover this paper. First one is that our study investigates for both the effects of bilateral and multilateral aid simultaneously on the country's economic growth. Secondly, this research uses longer an updated time period for analysis i.e. 1985 to 2015. And the objective of this research paper to see the effects of bilateral aid on Pakistan economic growth and also investigate the multilateral aid on Pakistan economic growth in Pakistan.

The rest of the study is ranged as follow. Section two discusses the empirical literature on the topic. The framework of the study has been discussed in section three. The empirical finding and discussion are discussed in section fourth.

Literature Review

This chapter will discuss the work and investigation at national level and the international level done by the various researchers. The foreign aid and their effectiveness has been a large discussion since 1960's. Albiman (2016) said that the first study was conducted by Harrod and domar in 1930s and 1940s. They argued that the foreign aid can improve the physical capital accumulation and then there is increase in the economic growth. Harrod Domar model concluded that, foreign aid filling the saving gap in developing countries (Albiman 2016).

Mosley (1980) led a review where he clarify that positive relationship between unfamiliar guide and financial development for UK supported nations and negative for French and Scandinavian helped nations. Nonetheless, he further depicted that help couldn't advance the financial conditions in Bangladesh, India Korea, Malawi and Kenya. Essentially, Lensink and Morrissey (2000) inspect the impact of help vulnerability on financial advancement in underdeveloped nations. They discovered the effect of help on monetary advancement relies on the guide levels and the steadiness of help streams. Moreover, Hansen and Tarp (2001) conducted a study in which they argued that aid enhanced growth because of capital accumulation and aid does not depend on smooth policies.

Biscaye, Reynolds and Anderson (2014) reported the impact of multilateral and bilateral Aid on development outcome. They have study 45 paper on whether the multilateral and bilateral Aid channels more effective for development goals. And they have concluded that 13 papers found that multilateral is more effective while other 13 paper find out that there is no significant effectiveness and 10 studies have max findings. And also find out that multilateral and bilateral Aid is more effective it depends upon the nations region and the macroeconomic policies.

Previous Studies for Pakistan

There are so many research was completed about the foreign aid and economic growth and now a day it is a hot debate between the economist and politician. Therefore, in the past there was empirical studies are done for example Mohey-ud-din (2005) studied that most of the countries to filled the two gap generally the import and export gap and saving and investment gap. He has been used the data from 1960 to 2002. He studied that there is poverty because of low income and low level of investment the saving rate is also low and when these problem occur so the government level is automatically low. So the government had faced the problem of deficit balance of payment and also faces the deficit the saving and investment gap. He used some econometric technique Two Gap Model. He has found that foreign Aid and GDP has inverse relation in Pakistan. And the entire coefficients are significant.

Ahsan (2007) investigate research paper about the Politicization of bilateral aid on educational development in Pakistan. The study conducted about the US and British aid to Pakistan on education sector. They have been study that the foreign aid is more important for the education part in Pakistan. There are two main bilateral donors who give the foreign aid to Pakistan the one is United States Agency for international Development (USAID) and the second one the British Government Department for International Development (DFID). Foreign aid is more operative in the educational if it free from politics. Further they study that in 1950 the foreign aid give in the form of grant element in this type of aid is reduce with passage of time and converted to loan form and repayable in the foreign currency. In 1989 Pakistan and USAID signed agreement for primary education USAID give US$280 Million. British aid gives the bilateral aid to Pakistan for Sind Primary Education Project £2.0 million.

Javid and Qayyum (2011) deliberated that Pakistan's economic growth has affected by foreign aid. They have used the data form 1960 to2008. They studied that the foreign Aid is greatly affect the economic growth in the case of Pakistan. They have also suggested that economic growth increases with the foreign Aid and also the agriculture sector in the developing countries. They have used in analysis both the Autoregressive Distributed Lag (ARDL) and simple OLS technique. They have further used the Unit Root Test and Bound test for co-integration. They have found that the foreign Aid positively affected the

economic growth when there are good macroeconomic policies and further find out, foreign Aid and real GDP have adversely affect the economic growth. However, when macroeconomic policies are good then there is positive relationship and significant.

Akhtar and Imran (2014) considered the US bilateral aid on economic growth of Pakistan. They discuss that Pakistan has the recipient country since 1947 of the Us Aid. Further they studied that the bilateral aid is to eliminate the poverty and improve the standard of living in the recipient country. They have studied that US have its own strategic policy motive in its foreign policy. They have been used data for the period of 1980 to 2010. They find that there is no serial correlation and Heteroscedasticity. Azam (2014) have deliberated a research paper on the foreign aid and he has been used the data from 1972 to 2012. Ha study that foreign aid mostly used for any natural disaster in the country like earth quack and floods and also used for the education and health facilities and reducing the poverty gap, infrastructure to promote the growth in the economy. First used the Unit Root test for the data Stationarity so for that we can used the Augmented Dickey Fuller test (ADF) and after this he used the Aikaike information criteria for the lag length. The afterward stage is to check the co-Integration test after that use the (ECM). They find out that foreign aid is negatively effects the real GDP. on the other hand, the result finds out that relevant to the effects of export on economic performances are definitely. He argued that most of the foreign aid use for consumption level and non-developmental program. He gives some policies for the management sector that the foreign aid can utilize in those channel which we can achieve the better economic growth and development. The good way to channelize the foreign aid in the energy sector, roads, because of these the country can promote the export.

Data and Methodology

The different study had used different model and also different variable like response variable and the explanatory variable and they are covering different times. So, Mohey-ud-Din (2005) covering the data from1960-2002 and employed two gap model in their analysis. He concluded that the foreign aid is helpful for the GDP and Official development assessment. Azam (2014) have been used the time series data from 1972 to 2012 and use the econometric technique is Error Correction Model (ECM). He used in their analysis dependent variable is real GDP per capita whereas the independent variable is the foreign aid, real export value, worker remittances, and error term. The main property of time series data is to check the Unit root test than used the co-integrating among the time series. And also there are different study have been done in the foreign country.

Selected Model for Estimation

So, on the above study we used simple linear regression model

$$NGDP_t = \alpha_0 + \beta_1 GFCF_t + \beta_2 MFA_t + \beta_3 LF_t + \beta_4 BFA_t + \in \qquad (1)$$

Where in equation (1) in model the response variable is nominal gross domestic product (NGDP) the explanatory variable are Gross capital formation (GFCF), multilateral foreign aid, labor force, and bilateral aid. the α_0 is intercept and $\beta_o, \beta_1, \beta_2, \beta_3$ these are the coefficient of the model and $\in$ s error term.

This study is based on dependent variables nominal GDP growth and descriptive variables Labor force, gross fixed capital formation, multilateral foreign aid and bilateral foreign aid. So it can be collect from different sources like labor force can be collect from different economics surveys of Pakistan. Multilateral and bilateral aid can be collect from the world Bank and also we use collect the exchange rate from the international monetary fund. In this study we use some Statistics technique and econometrics technique. First we formulate the Unit Root Test to check the stationarity and then we run the Jhonssen co-Integration to check the co-integration in the model. After that we run the error correction model to know the long run and short run variable. than we check for the serial correlation in the form that we can run the LM test and last we check the stability of the coefficient in the multiple regression analysis weather their stability is or not the Cusum test and Cusum square test.

Why we use ADF test and Jhonssen co-Integration

It is imperative for the time series data the data should be stationery simply stationery means that the data should not be changing with time. Because any time series which is not stationery may lead to spurious results which is not acceptable even with high R-squared values. Therefore, the property of time series data is that the variable should be stationery and for this purpose we use the Augmented Dickey Fuller test (ADF). Similarly, after having check all the variable for unit root now we can check the integration among time series variable (Azam, 2014). Moreover, if the variable are integrated of same order then we can run co-integration (Malik et al. , 2010). Furthermore the jhonseen co-integration mainly deals with to check the long run relationship of the variable in the model whenever there is more than two variable in the model (Habib et. , al 2013). So from the above discussion we conclude that our time series variable are integrated at the same order and that is why we run the jhonssen co-integration in the model.

Estimation Results and Discussion

The work based on the time series data so therefore we first check the unit root to check the stationarity in the data mean that the mean, variance and co-variance are constant over the time or not. For the stationarity in the model therefore we run the ADF test. ADF test based on the calculated ADF statistics at level 1 percent and 5 percent significance level and with their respective critical values. So all the variables are stationary at first difference.

Table 2: *ADF Results at level*

Variable	t-test	p-values	Critical values	
			1%	5%
NGDP	-0.023175	0.9490	-3.670170	-2.963972
LF	-0.397765	0.8973	-3.670170	-2.963972
NGCF	-1.320578	0.6068	-3.670170	-2.963972
MLAR	-2.483549	0.1293	-3.670170	-2.963972
BLAR	0.153489	0.9640	-3.699871	-2.976263

Table 2 shows us ADF test results. It is the most important feature of the time series data that data must be checked for stationarity. So on the basis of p values we can say that if the p values are greater than 0.05 so it would be called nan stationary at level. The dependent variable name is nominal gross domestic product (LNGDP) their p values are greater than 0.05 so it is nan stationery at level. And all the independent variable is not stationery at level.

Table 3: *ADF Results at 1st difference*

Variable	t-test	p-values	Critical values	
			1%	5%
NGDP	-5.797543	0.0000	-3.679322	-2.967767
LF	-7.837915	0.0000	-3.679322	-2.967767
NGCF	-5.276307	0.0002	-3.679322	-2.967767
MLAR	-6.917598	0.0000	-3.679322	-2.967767
BLAR	-5.631059	0.0001	3.699871	-2.976263

Table 3 shows us the (ADF) test or simply say unit root test. In the first column of the table there are the variables name the first one dependent variable and the other four variables are explanatory variable. So according to the above table and on the basis of p-values, the dependent variable Gross Domestic product (LNGDP) and its p values is 0.0000 and it is less than 0.05 so it is called Stationery. And all other four independent variables are stationery at level because the p values are less 0.05 so it is stationery.

Table 4: *Johansen co-integration results*

No. of C.E	Eigen-values	Trace statistics	Critical values (5% level)	Max-Eigen values	Critical values (5% level)
None *	0.873740	103.5016	69.81889	60.01303	33.87687
At most 1	0.606719	43.48858	47.85613	27.06367	27.58434
At most 2	0.259225	16.42491	29.79707	8.701688	21.13162
At most 3	0.168594	7.723220	15.49471	5.354458	14.26460
At most 4	0.078435	2.368762	3.841466	2.368762	3.841466

Table 4 shows us the Johansen co-integration. In the table there were six columns and six rows. Johansen co-integration mean that When there is starch at None and the trace statistics greater than critical values so it is one co-integration in the model. So simply we can assume the that the Null Hypothesis is that there is no co-integration in the variable and the alternative Hypothesis is that there is at least one co-integration. So, according to the Eigen values and trace values we compare both the values with critical values so we reject the null hypothesis and accept the alternative. And on the other hand the null Hypothesis is that there is one co-integration equation and the alternative hypothesis is that there is more than one co-integration so we did not reject the null Hypothesis.

Table 5: *Long Run Results of the Model*

Dependent Variable: LNGDP			
Name of variable	**Coefficient**	**Standard Error**	**T-Statistics**
LNLF	4.524818	(0.42351)	[10.6841]
LNNGCF	0.612145	(0.05398)	[11.3396]
LNMLAR	-0.157530	(0.04516)	[-3.48818]
LNBLAR	-0.337556	(-0.04066)	[-8.30294]

Table 5 shows the long run results of the Model. In the first column and first row shows the Labor force (LNLF) and the coefficient of the labor force is 4.524818 and highly statically significant t-statistics value of labor force is 10.6841. we say that If there is one percent increase in the Labor force so it well effect the dependent variable 4.52 percent and a positive relationship in the long run with dependent variable GDP. The second variable the net gross capital formation the coefficient is 0.612145 and this variable also highly significant and the t-statistics value is 11.3396. And if there is one unit change in the net gross capital formation so it well change in the response variable by 0.61 percent in the long run and it is positive relationship with dependent variable. The multilateral and bilateral aid has negative relationship with dependent variable nominal gross domestic product. The multilateral aid and their coefficient are -0.157530 and t values is -3.48818 and it is highly statistically significant If there is one percent change in the multilateral aid it well decreases the response variable -0.15 percent. Similarly, Bilateral aid and the coefficient are -0.337556 and its t values is -8.30294 so it is also highly significant and if there is one percent increase in the bilateral aid it well decreases the response variable by -0.33 percent.

Table 6: *Short Run Result of the Model*

Dependent variable LNGDP			
Variable Name	**Coefficient**	**Standard Error**	**T-values**
ECT (-1)	-0.343496	(-0.05471)	[-6.27893]
D(LNNGDP(-1))	-0.470004	(-0.15356)	[-3.06072]
D(LNLF(-1))	-1.384055	(0.26099)	[-5.30309]
D(LNLF(-2))	-0.503605	(0.17519)	[-2.87465]
D(LNNGCF(-1))	-0.280878	(-0.08138)	[-3.45147]
D(LNMLAR(-2))	0.024882	(0.01003)	[2.48193]
D(LNBLAR(-1))	0.100710	(0.01660)	[6.06768]

D(LNBLAR(-2))	0.04781	(-0.01438)	[3.32469]
C	0.284232	(-0.03694)	[7.69522]

Table 6 indicates the short run outcomes of error correction model. In first column and very first row is the Error correction term (ECT) or its mean the Co-integrationEq1. And there are some lags of the dependent variable and independent variable. The Error correction term (ECT) variable coefficient is -0.343496 and t values is -6.27893 and it is highly statistically significant because the coefficient is less than the t values. The economy is in equilibrium in the long run but now suddenly if there are shocks comes in the short run in the economy. so when we come out from that type of shock it well reaches the equilibrium point at the speed of 34 percent. similarly, all the variable is significant in the short run and some of the variable has negative coefficients and some variable has positive effect on the dependent variable in the short run.

Table 7: *Diagnostic Test Results*

Name	**Values**	**P-values**
LM test for Serial correlation	0.37059	0.6958
F- statistics	6.41	0.00327
R Squared	0.81	
Adj R- squared	0.68	
Cusum and Cusum square	5% significance	

Table 7 shows the Diagnostic Test results. Where in the table the first column and the2nd Row shows the serial correlation results its mean that the relationship between the variable and its lags or if there is covariance between and its lag value called the serial correlation. So here we can say that our Null Hypothesis there is no serial correlation in the variable and Alternative Hypothesis is that there is correlation between the variable. So we can see that the p values are greater than 0.05 so there is no serial correlation so we accept the Null Hypothesis and the reject the alternative. Where in the first the column and the third row shows the F statistics and F statistics talk about the joint Hypothesis of independent variables its mean that response variable jointly effects the dependent variable or not. So here the F statistics is 6.41 and their p values is 0.00327 so the p values are less the 0.05 so we can say that yes the response variable jointly effect the dependent variable. The fourth shows us the R-squared values is 0.81 mean that the explanatory variable explains 81 percent variation in the dependent variable (gross domestic product). Similarly, the five row shows us the Adj-R squared value is 0.68 mean that it explain 68 percent variation in the response variable. and also we run the Cusum and Cusum square test for the stability in the model so our findings show us that the model is stable in the parameter of the model.

This research paper shows us the negative results and there are no positive aspects of the foreign aid in case of Pakistan and it is also shows by Boone (1996) he showed that aid cannot increase or promote the economic growth. So this study is confirming that the aid cannot accelerate the economic growth and statistically it is negative or even say that adversely affect the economic growth. The labor force and gross capital formation is property to increase the growth. In this paper we run the diagnostic test such as R-squared, adjusted R-squared, LM test for the serial correlation, and also the Cusum test. These entire tests show us that the Model fit the data very well and there is no serial correlation in the model. The empirical results are meaningful and it is acceptable for further policy consideration.

Conclusion

This research based on the contribution of foreign aid in the form of multilateral and bilateral aid to economic growth of Pakistan. Foreign aid mean handover resources from the advanced nations to the developing nations are called foreign assistance.

Econometrics technique are used in this study are error correction model from the period of 1985 to 2015. In results, we found that multilateral and bilateral have negative relationship with the economic growth and their coefficient are (-0.15, -0.33) percent respectively. However, it means that if there is one percent

increase in the multilateral and bilateral aid it will decrease the economic growth by -0.15% and -0.33% respectively. Similarly, the labor force and Net Capital Formation has positive relationship with dependent variable (economic growth) and their coefficient are (4.52, 0.61) percent respectively. It also means that if there is one percent increase in labour force and Net Gross capital Formation it will enhanced the economic growth by 4.52% and 0.61% respectively. This study concluded that the foreign aid mostly used in the consumption purposes not for the development in Pakistan.

The policy recommendation is that first we need to improve the management who can used the foreign aid in the most efficient way to promote the economic growth. The second policy which is so important in case of Pakistan to concentrate on the Monterey, fiscal and trade policy to improve the investment in the domestic economy and then it can increase the economic growth and on the other hand if there is poor polices in the economy so it well negative effect on the economic growth.

Consequently, we can say that the foreign aid in the form of multilateral and bilateral aid is helpful for the economy to promote the economic growth (GDP) if there is a good macroeconomics polices work well in the domestic economy.

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Conflict of Interest

Authors have no conflict of interest.

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