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Poverty Reduction in Nigeria: Does Inflow of Foreign Aid Matter?

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Abstract

The rate at which poverty is still increasing in Nigeria is at alarming magnitude despite the high natural endowment and the huge sum of funds coming to the country through developmental aids. The study therefore set out to investigate the effect of foreign aids on poverty level in Nigeria using a time frame of 1986-2022. This study used secondary data that were collected from CBN Statistical Bulletin (2022) and Word Bank Development Indicator (2022). The study utilized Johansen Co-integration test and Fully Modified Least Squares (FMOLS) to explore the impact of foreign aids on poverty in Nigeria. The Johansen co-integration results confirmed the presence of a long-run relationship among the variables. The FMOLS results revealed that foreign aids, foreign direct investment and exchange rate were significant and indirectly related to poverty growth rate while trade openness was significant and positively related to poverty growth rate. Therefore, study concludes that inflow of aid and foreign direct investment explicitly reduced poverty rate in Nigeria and that exchange deprecation further aggravates the rate of poverty. In line with the findings of this study, it was recommended that government should seek for more of foreign aids from the donor countries and invest it in poverty alleviation progarmmes. Also, government must endevaour to formulate good policies especially ones that favour multinational corporations in order to encourage more of FDI into the country.

Keywords: *Poverty Reduction, Foreign Aid, FDI and Fully Modified Least Squares*

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Background to the Study

One of the fundamental economic issues affecting developing countries in particular Nigeria, is the persistent rate of poverty among their citizens despite huge resources possession they have. As such, it has become an economic discourse that has trailed developing economies on their inability to break away from the reoccurring economic quagmire for decades. For instance, the level of citizens with extreme poverty level in Tanzania was 19.9 million, Kenya 14.7 million, South Africa 13.8 million and Zambia 9.5 million as at 2019 (Worldwide Poverty Clock, 2019). Also, Worldwide Poverty Clock (2018) revealed that 86.9 million Nigerians out of the over 200 million people living in the country was below the poverty line of $1.90 per day in terms of consumption expenditure; by February 2019, this figure had risen to 91 million Nigerians living in extreme poverty.

However, one of the attempts made so far by developing countries to reduce the excessiveness of poverty within the region has been through persistent request for foreign aid from various international organizations (Iwegbu & Dauda, 2022). Aside this, many of the developing economies have made significant attempt to reduce poverty by strengthening their trade policies, eliminating institutional rigidities, and encouraging diversification of the economy. However, due to financial limitations arising from low savings and domestic investments, such policies have yielded little or no significant improvement in alleviating poverty (Augbaka *et al.*, 2019; Albiman, 2016).

Moreover, the developed economies have shown concern and commitment in helping the developing economies grow faster in alleviating poverty by providing foreign aids (Seedee, 2018). In view of foregoing committed aids of advanced countries to developing countries, there is a call in some quarters that foreign aids may go a long way in reducing the severity of poverty in developing nations. (Albiman, 2016; Adebayo & Afolayan 2019; Iwegbu & Dauda, 2022). According to Yiew and Lau (2018), foreign aids is the transfer of resources/wealth from developed nations or international financial institutions (IFIs) to less developed countries. Gondwe (2020) remarks that foreign aid is often given for economic, political or humanitarian purposes and can be classified as loans and grants, bilateral and multilateral aid or tied and untied aid.

In 1970, advanced countries agreed at the United Nation World Summit to give 0.7% of their gross national income (GNI) as official development assistance (ODA) to underdeveloped countries (Seedee, 2018). According to Chukwuemeka, Okechuku and Uchechi (2015), aid is often given to developing countries to economically improve their well-being and empower them. Nigeria as one of the leading economies in the African continent is getting the largest share of the aids and mostly accessible to it. According to World Bank (2017), Nigeria received the sum of 13.15 billion of US dollar as foreign aid in 2010-2015. With huge sum of funds coming through developmental aid, it serves as an important source of finance in most countries in Sub- Sahara Africa (SSA), including Nigeria, which supplements low savings, broaden the base of export earnings and tax bases in the SSA countries. Also, Chukwuemeka *et al.* (2015) corroborated the claims and reveal that foreign aid stimulates economic growth by supplementing domestic sources of finance such as savings, thus increasing the amount of investment and capital stock to the real sector.

Foreign aids take the form of disbursement of funds made on concessional terms and grants by official agencies of the members of the Development Assistance Committee (DAC), multilateral institutions, and by non-DAC countries. Foreign aids also include funds from official donors and territories of more advanced countries of Central and Eastern Europe; countries of the former Soviet Union, and certain advanced developing countries to developing countries (World Bank, 2019). The purpose of providing foreign aid is to promote economic development and improve the welfare of households in developing countries (Iwegbu & Dauda, 2022). Foreign aids can be tied to investment in education and health. This presupposes that foreign aid can help to augment the existing fiscal policy measures implemented at the start of every fiscal year. However, aid may not on its own effectively reduce poverty except there are operative fiscal and monetary policy measures (Augbaka, Awujola & Shcherbyna, 2019).

In spite of the useful of developmental aids to developing countries especially Nigeria as enumerated above, the ideal has cast doubt on foreign aids effectiveness in alleviating poverty over the years. Foreign aid critics have claimed that aid has been used to prop up corrupt governments in aid recipient countries. It was also stated that aid was frequently diverted away from its original purpose in order to enrich the elites, politicians, and some government officials in some recipient countries (Adebayo & Afolayan, 2019). Despite the large amount of foreign aids that enter Nigeria as a case study each year, the question of whether it has reduced the country's poverty rate remains unanswered. Hence, this necessitates the needs for this present study.

Literature Review

Concept of Foreign Aids

World Bank (2015) defined foreign aid as additional resources, which are used to raise the performance of the recipient country above the existing level. Asongu and Nwachukwu (2016) see it as the transfer of resources/wealth from developed nations or international financial institutions (IFIs) to less developed countries. Albiman (2016) made it known that utilization of developmental aid determines its outcome either to produce growth or not. Foreign aid could either be through bilateral or multilateral source for the purpose of promoting economic growth and development of the recipient countries.

Foreign aid is also known as developmental aid, foreign assistance, or external aid. Ever since the introduction British Colonial Development Act of 1929, developmental aid has evolved into what Oxfam (2008) refers to as more complicated issue with the foreign assistance effort of the US featuring 33 different goals, 75 priority areas and 247 directives. Other countries in the Development Assistance Committee (DAC) of the OECD, as well as some others not in this committee have also been instrumental towards providing foreign aid with donors rendering ODA on a bilateral basis (Organization for Economic Cooperation and Development, OECD, 2016).

Concept on Poverty

Addae-Korankye (2019) defines poverty as a pronounced deprivation of human wellbeing; which include vulnerability to adverse events outside their control, being badly treated by the institutions of state and society and being excluded from having a voice and power. Also, Nurkse defines poverty as a vicious circle and this implies a circular constellation of forces tending to act and react upon one another in such a way, as to make a country poor in a state of poverty. Meanwhile, poverty is in four folds, it could be relative, absolute, rural or urban (Falade, 2019). Poverty in term of relativity involves comparing the standard of living from one place to other, whereas absolute has to do with social amenities that are needed by citizenry for better living. Thus, people can be considered to be poor, when they do not have income and other resources required to fulfill the conditions of life such as diets, material, facilities goods and services; this requirement would have made them to play roles and participate in the relationships and traditions of their society (Wrangberg, 2018).

Furthermore, the subject of poverty has been a major issue on both national and international scale discussions, predominantly among the developing countries. According to Balogun (2009), poverty could be described as a condition where a society barely survives on a level of subsistence, coupled with limited access to the necessities of physiological factors- food, clothing, and appropriate accommodation, in view of maintaining a basic standard of living. World Bank and World Development Report (WB & WDR, 2009), suggest that conditions could be expressed as poor, if people live on a per capita income lower than US $370 at any given time or as being extremely poor by living on less than US$ 1 per day, and moderately poor by living on less than US$2 daily (World Bank, 2007). Again, the statement projects that "1.1 billion people in 2001 had expenditures below US$1 a day and 2.7 billion lived on less than US$2 a day." Poverty as a condition is not only confined to developing nations, but it is also a universal phenomenon that could be observed in a set of social problems including homelessness and the persistence of "ghetto" housing clusters (World Bank, 2007).

Empirical Literature

Ilesanmi and Agbede (2022) were concerned with the Nexus between foreign aid, poverty level and economic growth using Nigeria as a case study from 1980 -2020. The study adopted Vector autoregressive (VAR) in achieving the study objective. The VAR estimates showed that foreign aids exhibited positive sign and significance at 5% conventional level. This implies that the inflow of foreign aids into the economy was productive. A contrary conclusion was obtained using a Liberia economy as the scope of the study, Roosevelt (2018) carried out a study on foreign aid and extreme poverty using OLS from 1990-2016. It was confirmed through the OLS estimated result that foreign aid had a direct and insignificant effect on poverty. Hence, the study concluded that billions of dollars received in the country in form of aids has not reduced the extreme rate of poverty.

Edmore and Nicholas (2019) looked at the effectiveness of foreign aid on poverty reduction using a literature base research methodology. The study results obtained from the estimates show that foreign aid has a negative impact on poverty. The implication is that in general, foreign aid reduces poverty, irrespective of the type of poverty measures used. A study in ECOWAS was carried out by Nadri, (2017) on how official development assistance (ODA) influences poverty alleviation from1980 to 2014 using a panel data. The result discovered that ODA has insignificant impact on poverty in the study area of ECOWAS as well confirm insignificant impact on growth.

An interesting study in literature on both foreign aid and poverty reduction was carried out by Mahembe and Odhiambo, (2019). The study focused on reviewing empirical studies through proxied poverty in terms of non-monetary measures and non-monetary measures. The study showed that larger percentage of the existing studies reviewed confirmed that foreign aid positively impacted poverty. Hence, this showed that foreign aid inflow reduced the severity of poverty in the receiving countries when both non-monetary measures and non-monetary measures are used. A similar study was carried out by Wrangberg (2018) which used Quasi-experimental setting and threshold to establish the nexus between the two variables involved. The study considered 31 countries between 1987 and 2010. The result revealed that the estimated co-efficient of foreign aids exhibited an inverse relationship with poverty rate and it is insignificant; while the threshold technique noted that 41% foreign aids inflow was needed to achieve poverty reduction through foreign aids among the 31 selected African countries.

Also, Kirikkaleli *et al.* (2021) explored the nexus between foreign aid and Chad's economic growth. The study adopted annual data from 1982 to 2018. The study used ARDL technique to establish interconnection among the economic indicators. The result of the ARDL long-run estimates revealed that gross capital formation and foreign aid exerted insignificant impact on GDP growth rate. However, exports and imports exerted a positive and significant impact on GDP growth rate. Furthermore, the global financial crisis had a negative and significant impact on the economy of Chad.

Perveen and Ali (2021) conducted a study on the impact of official development assistance on sustainable development of Pakistan from 1976 -2017 using an Autoregressive Distributed Lag (ARDL) Approach. Estimation of Error Correction Regression resulted in a significant long-run relationship between ODA and Sustainable Development. Overall results of the study confirmed a positive and significant relationship between ODA and the measure of sustainable development in Pakistan. A comparable study by Mustafa, Elshakh, and Ebaidalla (2018) studied the relationship between foreign aid and economic growth in Sudan using time series data ranging from 1980 to 2015. The study likewise employed autoregressive distributed lag (ARDL) bounds tests for co-integration. The result revealed that foreign aid impacted positively on the economic growth in the short run in Sudan, but negative with corruption in public institutions in the long run.

Yiew and Lau (2018) empirically investigated the role and the impact of foreign aid (ODA) on economic growth (GDP) using 95 developing countries as the sample. The panel data results indicated that a U-shape relationship exists between foreign aid and economic growth. The result showed that foreign aid negatively impacted the countries' growth. Further, the results strongly support the view that both FDI and POP are more important determinants of GDP, which implies that GDP is less likely to depend on ODA. Furthermore, Abeselom (2018) investigated the impact of foreign aids and sustainable growth in Ethiopia from 1980 to 2015 using a panel pool data. The estimation result from the study shows that external debt and official development assistance had a negative and statistically significant effect of sustainable growth in Africa. Foreign direct investment also had insignificant positive influence on sustainable growth.

Asongu and Nnanna (2018) base the study on empirical evidence from 53 African countries with data for the period 2005-2012 using a Generalized Method of Moments. The results revealed that whereas foreign aid improves inclusive human development in the short-run, it decreases it in the long term. Policy implications are discussed with particular emphasis on reinventing foreign aid for sustainable development in the post-2015 development agenda. In addition, Adams and Elassal (2020) was interested in if aid flows have contributed to economic growth or growth divergence between a sample of Asian and African countries using data over the period of 1980–2015. The study adopted a panel data fixed-effects model for each sample (Africa and Asia) between 1980 and 2015. The findings strongly suggested that aid flows in both the Asian and African samples have no relation at all to either long-run growth paths or growth divergence. However, there is a suggestion in the case of the Africa sample that governance decline may well be the primary source of growth divergence. It could also be argued (given the comprehensive literature analysis presented here) that it is not essential to have a theoretical relationship between aid and growth because aid is given to different countries with very different characteristics, needs, governance and policy environments.

Theoretical Framework and Methodology

The theory of Trickle-down growth as proposed by Laffer in 1980 was considered as the theoretical framework adopted in this present study. The theory avows that the accumulation of wealth by the rich is good for the poor since some of the increased wealth of the rich trickles down to the poor. The theory suggests some vital ways in which the accumulation of wealth by the rich national might trickle down to the poor nation and this might lead to a unique steady-state distribution of wealth under sufficiently high rates of capital accumulation, and further argues that there is still room for wealth redistribution policies to improve the long-run efficiency of the economy.

Additionally, Sen (2002) established the inks between the rich and the poor which can be determined by estimating the incomes of the poor and rich to each other. For instance, trickle down growth can be estimated through the following equations:

$$Y_{ip} = \alpha + \beta_r Y_{ir} + e_i \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(i)}$$
$$Y_{ir} = \alpha + \beta_p Y_{ip} + e_i \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(ii)}$$

Where Y_p and Y_r represent the per capita incomes of the poor and rich, respectively, and β_p and β_r represents class income transfer's coefficients. The βs reveal the proportionate increase in one group's per capita GDP as a function of the other group's per capita GDP. For example, β_r represents the change in the income of the poor nation attributable to the change in the income of the rich nation. The theory believes that for theory of trickle-down growth to be achieve, β_r should be positive. However, if trickle-up is true, the coefficient should be negative. Therefore, trickle down growth suggest that the wealth of rich tends to trickle down to the pro poor and thereby reduces poverty over time.

The model for this study for objective two will be built upon Adebayo and Afolayan (2019) model. Therefore, the basic model for Adebayo and Afolayan (2019) is given below;

HCP = F (FA, FDI, and INF) …. …… …. (iii)

Where; HCP = Household Consumption per Capita, FA = Foreign Aids, FDI = Foreign Direct Investment Inflow, INF = Inflation rate

Therefore, the modified model is re-specified as follows:

POV = f (AIDS, FDI, EXCH, TRADEOP) …. …… …. (iv)

Where; POV = Poverty growth rate, AIDS = Foreign aids, EXCH = Effective exchange rate

TRADEOP= Trade openness

Where the econometric form of equation (iv) becomes

$POV = \beta_o + \beta_1 AIDS + \beta_2 FDI + \beta_3 EXCH + \beta_4 TRADEOP + \mu_t$ ….. …….. ……. (v)

Table 1: Definition and Measurement of Variable

Variables	Measurement	Source
POV	Poverty was calculated by Multidimensional Poverty Index (MPI). MPI measures by three dimensions and 10 indicators such as: health (child mortality, nutrition), education (years of schooling, enrolment) and living standards (water, sanitation, electricity, cooking fu el, floor, assets). Therefore, the sum of three dimensions will be used to capture poverty	Word Bank Development Indicator, 2023
AIDS	Foreign aid will be measured by the sum of official development assistances divided by GDP at constant price	Word Bank Development Indicator, 2023
FDI	The sum of cash inflow divided by gross domestic product at a constant price	Word Bank Development Indicator, 2023
EXCH	Monthly average official exchange rate of naira relative to US dollar (₦/$)	CBN Statistical Bulletin 2021
TRADEOP	The sum of imports and exports of goods and services divided by GDP in constant prices	CBN Statistical Bulletin 2021

Source: Researcher's compilation (2023).

Results and Analysis

Table 2: Descriptive Statistics

Statistics	POV	AIDS	FDI	EXCH	TRADEOP
Mean	51.94694	2.849722	5.808280	110.8625	207.8468
Median	53.90000	1.740000	6.079445	100.2500	167.9326
Maximum	68.54000	17.38000	15.26111	275.2900	566.8724
Minimum	27.20000	0.190000	0.047189	50.17000	0.867504
Std. Dev.	12.60293	3.463407	4.715286	54.34289	176.6557
Skewness	-0.575306	3.006249	0.307463	1.865224	0.421442
Kurtosis	2.339870	12.20798	1.841930	5.785424	1.940307
Jarque-Bera	2.639523	181.4057	2.578889	32.51223	2.750105
Probability	0.267199	0.670982	0.275424	0.651000	0.252826
Sum	1870.090	102.5900	209.0981	3991.050	7482.484
Sum Sq. Dev.	5559.183	419.8317	778.1873	103360.2	1092253.
Observations	36	36	36	36	36

Sources: Obtained value from E-view 9 (2023)

It was discovered that trade openness (TRADEOP) exhibited highest value of mean amongst the studied variable; while, foreign aids (AIDS) showed minimal impact. The economic implication is that within the study years, the inflow and outflow of goods and service within the Nigerian economy has much impact on the rate of poverty in the country averagely. A similar trend was followed by median value. Also, trade openness (TRADEOP) showed highest value amongst the sample variables; hence, suggesting that there were main economic activities that took place in the session than another studied variable. The rationale for this is attributed to crude oil acting as the main stay of the country mean of revenue; as such, more economic activities took place in the session that impact poverty substantially. The finding for the standard deviation implies that trade openness (TRADEOP) has the highest values around the mean; followed by other variables. Finally, the Jarque-Bera test statistics for testing whether the series is normally distributed showed that poverty growth rate (POV), foreign aids (AIDS), foreign direct investment (FDI), exchange rate (EXCH), trade openness (TRADEOP) were normally distributed, since their corresponding p-value was greater than 5%.

Unit Root Estimate

Table 3: Augmented Dickey-Fuller

Variables	T-Statistics	Conclusion
POV	/4.720987/ 0.0022**	I(1)
AIDS	/6.666430/ 0000**	I(1)
FDI	/4.172070/ 00001**	I(1)
EXCH	/4.425103/ 0003**	I(1)
TRADEOP	/5.780109/ 0000**	I(1)
** *represent significant p*-value		

Sources: Obtained value from E-view 9 (2023)

As shown in Table 3, it was established that poverty growth rate (POV), foreign aids (AIDS), foreign direct investment (FDI), exchange rate (EXCH) and trade openness (TRADEOP) were stationanary (NS) at first level difference. Hence, suggests that all the variables were not affected by issue of stationary.

Table 4: Johansen Co-integration

Trace Statistics			**Max-Eingen Statistics**		
Level (H0)	T-Statistics	Critical Value(5%)	T-Statistics	Critical Value(5%)	Conclusion
r = 0	75.62392	69.81889**	43.54969	33.87687**	Long-run confirmed
r = 1	52.07423	47.85613**	32.18656	27.58434**	Long-run confirmed
r = 2	19.88767	29.79707	11.58716	21.13162	None
r = 3	8.300513	15.49471	7.777566	14.26460	None
r = 4	0.522948	3.841466	0.522948	3.841466	NoNe
** *indicates long-run relationship*					

Sources: Obtained value from E-view 9 (2023)

It was confirmed that two long-run relationships did occur amongst the sampled variable. Hence, they exhibited a high degree of relationship in the long-run.

Table 5: Fully Modified Least Squares (FMOLS)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AIDS	-0.578029	0.258410	-2.236868	0.0167**
FDI	-0.410438	0.139391	-2.944510	0.0024**
EXCH	-0.031495	0.015378	-2.048060	0.0499**
TRADEOP	0.040695	0.013102	3.105974	0.0040**
Constant	4.294905	0.374765	11.46025	0.0000
R-squared	0.652067			
Adjusted R-squared	0.561684			
*** indicates statistically significant at 5% significance level*				

Sources: Obtained value from E-view 9 (2023)

It was discovered that foreign aids (AIDS), foreign direct investment (FDI) and effective exchange rate (EXCH) proved significant with an indirect effect on poverty growth rate (POV); while, trade openness (TRADEOP) was also significant with a direct effect on poverty growth rate (POV).

Discussion of Findings

The absolute coefficient of foreign aids (AIDS) was 57.8% and was inversely related to poverty growth rate (POV). This means foreign aid has the capability to reduce poverty as against the criticism in certain quarters that foreign aid was counterproductive. The implication of this finding on poverty level is that more inflow of foreign aid into the country drastically reduces the severity of poverty among the citizens. The finding showed that official development assistance from rich nations could trickle down to poor nation as claim by theory of Trickle-down growth as proposed by Laffer in 1980. The finding agreed with the *a priori* expectation of the study. Also, studies like Ilesanmi and Agbede (2022), Edmore and Nicholas (2019) and Tersoo and Abubakar (2019) confirmed an inverse and significant relationship between foreign aids and poverty growth rate, with a conclusion that inflow of aids in terms of cash and kinds reduce the severity of poverty; while, Nadri, (2017) and Roosevelt (2018) also established an indirect and a significant effect between foreign aid and poverty reduction.

The coefficient of foreign direct investment (FDI) was 41.0% with a negative relationship with poverty growth rate (POV). This was in consonance with the *a priori* expectation that negative relationship exists between poverty and investment. The implication of this was that as investment was increasing, poverty was reducing in the economy, therefore, serves as a robust determinant for poverty reduction. This finding obtained from the investment sign was in-line with the study of Udeorah and Aborh (2018) that investment especially in FDI is a panacea for poverty reduction in Nigeria. Given this, Iwegbu and Dauda (2022) and Augbaka (2019) confirmed a negative and significant relationship between foreign direct investment and poverty growth rate in Nigeria.

The coefficient of exchange rate (EXCH) was 3.1% and indicated that a negative relationship existed between exchange rate and poverty growth rate (POV) in tandem with the *a priori* expectation of the study. The implication of this negative sign is that exchange appreciation makes local production costlier than imported goods; therefore, lead to fold-up of many organizations that worsen the situation of unemployment in Nigeria. As such, Tersoo and Abubakar (2019) and Adebayo and Afolayan (2019) also arrived at a similar finding in their respective studies.

The coefficient of trade openness (TRADEOP) (4.0%) was significant and directly related to poverty growth rate (POV). This positive sign could be interpreted as higher rate of imported goods than exported goods that worsen production in the local industries, which in turn, increases the unemployment rate that leads to higher rate of poverty. As such, unemployment could not reduce poverty; it could only complicate it and worsen it.

Conclusion and Recommendation

As shown from the FMOLS result, it was established that foreign aids, foreign direct investment and effective exchange rate proved significant with an indirect effect on poverty growth rate; while, trade openness was also significant with a direct effect on poverty growth rate (POV). The study concluded that inflow of foreign aid has reduced the rate of poverty growth in Nigeria. Therefore, the study recommended that government should seek for more of foreign aids from the donor countries and invest it in poverty alleviation progarmmes. Government should also endevaour to formulate good economic policies especially ones that favour Multinationals Corporation in order to encourage more of FDI into the country. The apex bank should not alone leave the exchange rate policy into the hand of demand and supply, but rather apply also artificial regulation through income involvement when the needs arise especially during exchange rate volatility. Furthermore, government has to invest massively into the economy to promote local production that positively impacts exportation.

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