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IMPACT OF THE FINANCIAL CRISIS OF 2008 ON FOREIGN AID INFLOWS TO GOVERNMENT AND NON-GOVERNMENTAL ORGANISATIONS IN KENYA

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Abstract

Purpose: The purpose of this study was to determine how the financial crisis of 2008 impacted foreign aid inflows to government as well as non-governmental organizations.

Methodology*:* The study was qualitative in nature and used a research design that is descriptive in nature. The research reviewed recent literature on the determinants of foreign aid allocation to Kenya both bilateral and multilateral aid. Secondary data was collected from World Bank development indicators, surveys conducted by the Kenya government, strategic plans, financial and narrative reports, publications, policy documents and other relevant documents. The target population of the study included the ministry of foreign affairs with the aim of understanding the foreign policy of the various government regimes as well as the ministry of finance. International non-governmental organizations also formed part of the target group to enable us understand the criteria used for their disbursement of foreign aid to Kenya.

Results*:* Based on the findings the study concluded that global financial crisis influenced the foreign aid inflows to Kenya.

Unique contribution to theory, practice and policy: Based on the findings the study recommended that governments should invest the foreign aid inflows into broader economic programs such as eradication of poverty and health improvement. This will boost the donors' confidence that their support is being appreciated by the recipient countries.

Keywords: *financial crisis of 2008, foreign aid inflows, government. Non-governmental organizations*

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1.0 INTRODUCTION

1.1 Background of the Study

Foreign aid is a post-world war II phenomenon that came about when western states had the notion that poor countries were in a low income equilibrium trap and needed to supplement their low income savings with foreign savings in the form of official development assistance (ODA) and foreign direct investments (FDI). All this was done to promote capital formation and increase economic growth. Aid also had other objectives which included poverty alleviation, bridging the gender gap and promoting good governance.

In 1970, developed countries agreed to contribute 0.7 percent of their gross national income (GNI) as official development aid annually. Billions have been given each year, but the targets promised are yet to be reached[1]. Foreign aid as mentioned in the United Nations Resolution was to be untied and any financial and technical assistance given was to be directed mainly for economic and social progress of the developing countries and not to be used by the donor nations as a way to undermine the national sovereignty of the receiving nations.

Foreign aid for years has been criticized. This is due to the failure of aid to meet the expectations of driving economic growth and alleviating poverty. There are perceptions that have to be considered with regards to foreign aid. According to Burnside and Dollar aid can only lead to increased economic growth in a good policy environment.[2] Lancaster argues that where the political and economic environment are right, aid supports both economic and social progress, but where it is not, it will have a negative effect and will be wasted at best. At worst it will regress development. In this case then foreign aid is like a double edged sword[3].

There was also the perception that aid given on conditionality terms would lead to faster economic growth. This was done through the International Monetary Fund and World Bank Structural Adjustment Programmes. This also failed as governments failed to meet their end of the deal, Governments promised reforms, but failed to implement these reforms.[4] Gunning believes that foreign aid should be given ex ante conditionality. His view is that conditionality works against ownership reforms, discourages policy making capabilities and makes governments unaccountable. Through selectivity donors are able to enhance and meet development goals rather than achieve political objectives.[5]

Hirvonen criticized foreign aid as being designed to serve the economic interests of donor countries or to benefit powerful domestic groups. In his view aid is based on donor interests instead of the interests and needs of the recipient countries. That aid is not disbursed to the countries that desperately need it and that aid is often wasted on overpriced goods and

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services from donor countries.[6] In 2008, the Accra Action Agenda was set forth and it proposed for developing countries to take ownership of their development strategies by designing their development policies and taking leadership in coordinating aid received. An all-inclusive partnership was also proposed where not only development assistance committee countries were considered, but new donors and foundations and civil societies that will participate fully in impacting development[7].

Foreign aid to Kenya has either been bilateral in nature which is assistance directly from one country to another or multilateral where resources are pooled together from many donors. Bilateral aid to Kenya has been at 78 percent and multilateral aid increased in the 1980s and 90s due to World Bank and International Monetary Fund structural adjustment programmes.[8] The below figure A1 shows the amount of official development assistance and official foreign aid that Kenya received in the period 1980 to 2014.

The period 1980-1989 saw a steady increase in foreign aid allocation to Kenya due to the need to cushion the economy from the effects of the structural adjustment programmes and the need to ensure the continuity of the reforms that the government was undertaking. From the year 1990 there was a dip in foreign aid disbursements due to the governments strained relationship with development partners after aid was received but not used for the purposes it was allocated for. An increase is noted from 2001 and this is mostly due to the change in regime from President Daniel Arap Moi to Mwai Kibaki.

Kenya has also experienced major standoffs with international financial institutions especially the World Bank and the International monetary fund during the period of structural adjustment programs and enhanced structural adjustment facility that led to aid freezes. In July 1982, the World Bank withheld disbursement of the second tranche of 50 million US dollars on the basis of laxity on policy reforms and funding only resumed in 1984 after new agreements were drawn up[9]. The fiscal year 1989/90 saw aid inflows exceed the total of all other foreign exchange receipts and Kenya at the time was ranked the eighth largest aid recipient in the world with aid amounting to over 11.5 percent of the gross domestic product[9]

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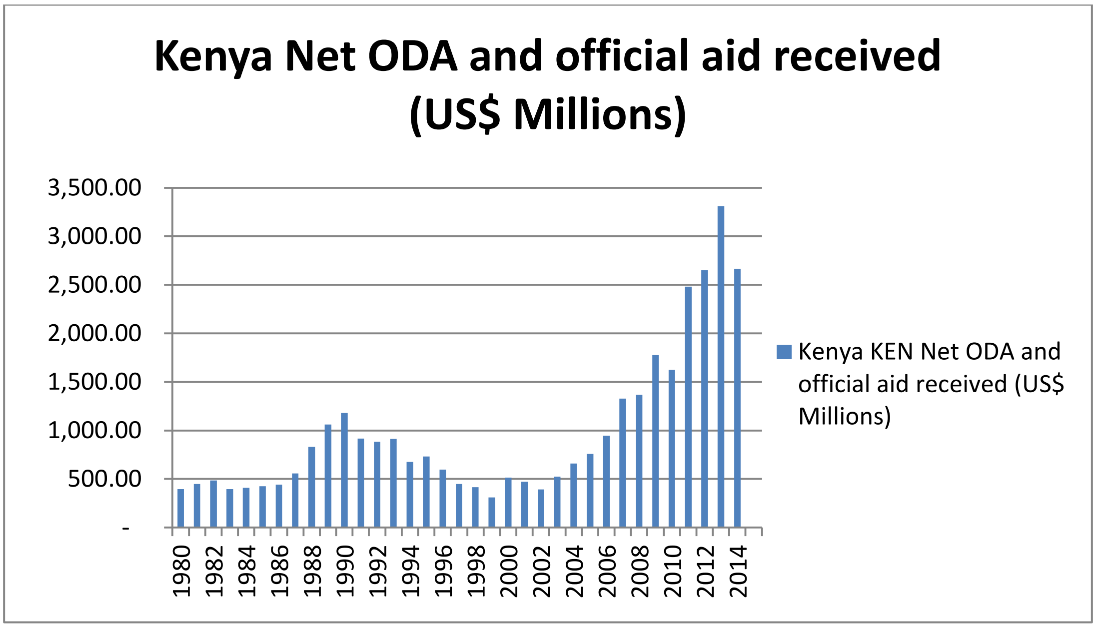

Source: Based on World Bank Development Indicators July 2016

Figure 1: Net ODA and official aid received in Kenya. (1980-2014)

1.2 Problem Statement

Foreign aid has played a major in the economic growth and development of developing countries making it an issue of intense debate. Developing countries have been the biggest recipients of foreign aid since its role is to alleviate poverty. Numerous studies have been conducted on the role of foreign aid on economic development with a focus on its impact on government expenditure, domestic savings and domestic resource mobilization most importantly taxation. These studies have had mixed results on what role foreign aid plays. Studies have also been conducted on the effectiveness of foreign aid to economic development and foreign aid has been shown to be successful in some areas and lacking in others especially in African countries. There has also been a lot of focus on aid dependency and the heavy debt burden that African countries have due to soft loans given to them either from bilateral or multilateral agreements. Sub Saharan countries have high levels of indebtedness, unemployment, poverty and poor economic performance yet they are the largest recipients of foreign aid inflows.[9]

Research on foreign aid in relation to Kenya has revolved largely on its impact on economic growth and development. Studies have also touched on issues of aid unpredictability and the impact that foreign aid has no investments as well as the macroeconomic effects of foreign aid. All these studies have failed to take into account the factors that determine foreign aid inflows into Kenya. This study therefore aims to fill this gap by conducting research that will determine the factors both internal and external that influenced foreign aid inflows into Kenya during the period 1980-2015.

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1.3 Research Objective

To determine how the financial crisis of 2008 impacted foreign aid inflows to government as well as non-governmental organizations

2.0 LITERATURE REVIEW

2.1 Theoretical Framework

Foreign aid inflows can be explained as being affected by two issues the recipient country needs and donor interests. A recipient needs model is derived from assumptions of the moral obligation to help those in need. Arguments are that recipient countries determine the amount of aid inflows they receive over time. On the other hand the donor interest model is based on the assumption that foreign aid inflows are given depending on the strategic and economic interests of the donor countries.

A recipient needs model therefore fits in the idealist theory of international relations where the basis of giving foreign aid is solely from the motivation of the state actors and individuals. Idealists believe that states are interdependent and they need to cooperate on the international arena. They believe that states have a right to practice political independence, but have a mutual obligation to one another and states must fulfill these obligations. Idealists are not content with the world as is and are constantly trying to change it to what the world should be.

In using this theory there is the assumption that foreign assistance is given on the basis of economic, social and political needs of the receiving country. It assumes that foreign aid inflows are on the basis of humanitarian concern for the recipient country. Recipient needs could entail poverty levels, mortality rate and population, human and political development among others. By focusing on giving aid on the basis of the needs of the receiving country it therefore means that countries lacking in areas supported by foreign assistance would receive more aid than countries that are better off in those areas. Idealists therefore believe that foreign aid inflows are based on the willingness of the donor country to play its role in the international arena by supporting a country even though it has a bad political system and the donor will use conditional aid to bring reforms or will give aid where the recipient has shown to be making strides at being democratic and is upholding human rights.

The realist theory of international relations can be used to explain the donor interests on determining foreign aid inflows to developing countries. The classical realist view is that foreign aid is given by developing nations in order to advance their own political and military positions. In this theory the main actors in international relations are the state who are concerned with their own security and always act in pursuing their own national interest and struggle for power.

The realist theory view human beings as being inherently egotistical and self centered to the extent that their self-interest overrides their moral principles. Realists view the international arena as a self-help system where a state is responsible for its own survival and is free to decide how to become more powerful and define its interests. With regard to foreign aid therefore, the donor takes into consideration the economic environment and potential of the recipient's country as well as the disparity in the economy of the donor and recipient to show who is more powerful. For instance donors tend to give more aid to countries that vote with

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them at the United Nations sessions.[12]Realists also believe that morality does not exist in international politics and if morality exists then it is to justify state action.

Realists with regards to foreign aid will give foreign aid to states that are able to enable them actively pursue their national interests and ensure that there is security in the international community. This study by using both the idealist and realist theories of international relations will aim at displaying how these theories are interlinked to the foreign aid inflows to Kenya based on the principles of the two theories with dealings in the international platform.

2.2 Empirical Review

The financial crisis that alarmingly threatened to collapse the global economy came in three stages. Firstly, the authors note that there was a decline of the stock indices of the world's leading banks and financial institutions in 2007 which was provoked by a transfer of risk capital from developed markets to emerging markets[10]. In early 2008 the crisis unfolded again which resulted from a continuing fall in world stock markets that spilled over from 2007. This in turn resulted to fallout triggered by the redirection of cash flows from one class of assets to another, particularly to commodities and energy resources. The third wave of the global financial crisis is currently unfolding[10]. This crisis is being defined by a serial bankrupting of the world's leading financial companies though interventions such as government bailouts and the International Monetary Fund are being implemented to help ease the situations.

The world economy in 2008-09 experienced its most severe financial shock since the "Great Depression" of the 1930s and the deepest economic downturn since the Second World War. Although national financial crises occur fairly periodically, global financial crises are extremely rare, this being only the third such global crisis since the "Long Depression" of 1873-79.2 Concomitant with the current "Great Recession" was a "Great Trade Collapse" whereby world trade declined rapidly beginning in the third quarter of 2008 through the second quarter of 2009[11].

In the United States the financial crisis started in 2007 and involved financial institutions in many OECD countries. It was only when the crisis turned into a global economic recession that developing and emerging market economies were affected, mainly through the trade channel, and in some cases through workers' falling remittances. In many developing countries, the economic consequences of these indirect effects were as severe as the direct effects were on developed countries. The worldwide recession, the first since the Second World War, led to a reduction of world gross domestic product (GDP) by 0.6 per cent in 2009. In the absence of counter cyclical responses, the slump could have been much stronger[11].

Despite the past and current controversies about the usefulness of foreign aid inflows into Africa, one cannot refute the fact that poverty-reducing initiatives across the continent have contributed to sizeable increase in foreign aid inflows over the past decade. At the 2005 G8 Summit in Gleneagles, Scotland, member countries pledged to "double the total aid volume by 2010 compared to 2004, and that half of this increase should be allocated to Sub-Saharan Africa." According to a recent study by The Nordic Africa Institute, aid to Sub-Saharan Africa increased by about 23 percent between 2005 and 2006, and that most of the increase was due to the debt relief to Nigeria and other countries in the region, and that if we exclude the debt relief to Nigeria, foreign aid to the rest of the region remained at its 2 percent level in 2004[12].

All African countries, except the Republic of Congo, Liberia, Libya, Somalia, and Tanzania, are in the group of 120 aid recipient countries. This may explain why in early September of 2008, African leaders launched a preemptive warning, perhaps in anticipation of the adverse consequences of aid reduction to the region, that they may fall short of meeting their United Nations goals of reducing poverty and the Millennium Development Goals (MDGs) if advanced countries use the financial crisis as the basis to slash foreign aid commitments to Africa. Sub-Saharan Africa is the largest foreign aid recipient, either as percent of GDP or as percent of gross capital formation, among the developing regions of the world. According to the most recent IMF projections, foreign aid to low income countries (mostly in Africa) has started to decline in 2009, and this would have adverse impact on the top 30 foreign aid recipient countries in the region where foreign aid as percent of GDP range from a low 0.3 percent in Algeria to a high of 75.2 percent in Sao Tomé and Principle – the number one aid receiving nation as percent of GDP.

The direct impact of the financial crisis on the African economies has thus far been limited as most commercial banks in the region refrained from investing in the troubled assets from the US and other part of the world. This is why most commentators argue that Africa is so far insulated from the direct effects of the financial crisis. The current financial crisis affects Africa and other developing countries in two possible ways; First, there could be financial contagion and spillovers for stock markets in Africa. Stock markets in the region showed some volatility, driven by a sell-off by foreign investors. The Nigerian stock market for instance has been experiencing a continuous downward trend in prices of stocks for over two months now. The India stock market dropped by 8% in one day at the same time as stock markets in the USA and Brazil plunged. Stock markets across the world developed and developing have all dropped substantially since May 2008. Share prices have tumble between 12 and 19% in the USA, UK and Japan in just one week, while the MSCI emerging market index fell 23%. This includes stock markets in Brazil, South Africa, India and China[13].

The global financial crisis did not spare Kenya and its challenges are felt over[14]. He notes that the banking sector was greatly hit by the crisis. For example, he says that the stock market and the agricultural sector were greatly affected. The global financial and economic crisis has affected African countries and people causing severe social and economic upsets.

Since the 1980s, the country has experienced relatively unpredictable flows of international aid. According to OECD Development Assistance Committee (DAC) statistics, while Kenya experienced a dramatic build-up in nominal aid flows in the 1980s, there was a slackening of donor support in the 1990s. Nominal aid flows increased from US$393.4 million in 1980 to an average peak of $1120.5 million in 1989-1990, before declining to a low of $308.85million in 1999 and $391 in 2002, with some recovery thereafter with the coming of a new government in December 2002[14].

Nguyo[15] noted that financial crisis is a situation where the money demanded quickly rises relative to the supply. Some financial institutions or assets suddenly loose large part of their value. A financial crisis may be caused by leveraged investments. This means borrowing to finance investments. When a financial institution (or an individual) only invests its own money, it can in the very worst case lose its own money. Financial crisis have been prevalent phenomena throughout history. NGOs in Kenya were affected in their provision of services during the 2008 and 2009 when the effects of the Global Financial Crisis (GFC) were felt. It is expected that number of NGOs in Kenya will report a substantial reductions in their funding in the wake of the global financial crisis, and this is expected to threaten their ability to deliver the services and activities that are required. The objective of this study was to investigate the effects of the global financial crisis on financing of NGOs in Kenya[15]. This study employed descriptive research design. The study relied mostly on primary data sources. Basing on the study findings, the study concluded that financial crisis increase affected the financing of NGOs in Kenya. The study reveals that during the global financial crisis, most of the NGOs rely mostly on their budgets and saving from their accounts since financier could not meet financial needs during this period. On expenditure of NGOs during the global financial crisis, the study concluded that financial crisisthat was experienced during the year 2009-2010 resulted to employment of more international staffs with experience and professionalism in handling disasters as a way of delivering effective services to the community. To staffing, the study concluded that NGOs were staffing gradually from each year to the other while only during 2012 when decrease of staffing was experienced in almost all the organizations.

3.0 RESEARCH METHODOLOGY

The study is qualitative in nature and will use a research design that is descriptive in nature. The target population of the study will include the ministry of foreign affairs with the aim of understanding the foreign policy of the various government regimes as well as the ministry of finance. International non-governmental organizations will also form part of the target group to enable us understand the criteria used for their disbursement of foreign aid to Kenya. The state of population under study will be identified and random sampling will be used to represent the issue under study. Secondary data will be collected from World Bank development indicators, surveys conducted by the Kenya government, strategic plans, financial and narrative reports, publications, policy documents and other relevant documents will also be reviewed. The researcher will use analysis of variance (ANOVA) to provide in depth information on the study. Quick references to information will be made especially for non-experts.

4.0 RESULTS AND DISCUSSIONS

4.1 Hypothesis Test

Statistical Test for Hypothesis two: H_2= Global financial crisis did not influence the Foreign Aid Inflows to Kenya.

To test this hypothesis, an Analysis of Variance was conducted. The output for the Analysis of Variance included means, standard deviation, minimum and maximum values of ODA for each period (pre, during & post). The mean flow of foreign aid before the global financial crisis was 656,390,000, 1,489,646,667 and 2,547,004,000 US$ during and after the global financial crisis respectively. Post global financial crisis period had the highest variation in foreign aid flow as shown by a standard deviation of 605,181,155, followed by global financial crisis period with a standard deviation of 248,934,485. The pre global financial crisis had the least deviation of foreign aid inflows with a standard deviation of 213,384,584.

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Table 1: Analysis of Variance

Period	**Number of years**	**Mean**	**Std. Deviation**	**Minimum**	**Maximum**
Pre Global financial crisis	5	656,390,000	213,384,584	392,810,000	946,700,000
During Global financial Crisis	3	1,489,646,667	248,934,485	1,326,780,000	1,776,200,000
Post Global financial crisis	5	2,547,004,000	605,181,155	1,624,650,000	3,311,620,000
Total	13	1,575,839,231	945,871,404	392,810,000	3,311,620,000

The Analysis of Variance indicates that the hypothesis "Global financial crisis did not influence the Foreign Aid Inflows to Kenya" should be rejected since the reported probability value (0.000) was less than the critical p-value of 0.05. The rejection of the Null hypothesis implies that Global financial crisis have a significant influence on foreign aid inflows in Kenya. Global financial crisis, therefore, influenced the amount of foreign aid that Kenya received. The results were also supported by an F-statistic of 25.31.

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Table 2: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	8.96503E+18	2	4.48251E+18	25.31	0.000
Within Groups	1.77105E+18	10	1.77105E+17		
Total	1.07361E+19	12			

Post Hoc Analysis was conducted to bring clarity of intra-period differences in relating to foreign aid. Results indicate that foreign aid inflows in the pre global financial crisis period were 833,256,666.667 lower than inflows during the global financial crisis period. The difference in foreign aid inflows in the two periods was significant as shown by a P-value of 0.000. Results also indicate that foreign aid inflows in the pre global financial crisis period were 1,890,614,000.000 lower than inflows in the post global financial crisis period. The difference in foreign aid inflows in the two periods was significant as shown by a P-value of 0.000. Results further indicate that foreign aid inflows during the global financial crisis period were 1,057,357,333.333 lower than inflows in the post global financial crisis period. The difference in foreign aid inflows in the two periods was significant as shown by a P-value of 0.000.

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Table 3: Post Hoc Test Analysis

(I) GFC Dummy	(J) GFC Dummy	Mean Difference (I-J)	Std. Error	Sig.
Pre Global financial crisis	During Global financial Crisis	-833256666.667*	307336566.9	0.022
	Post Global financial crisis	-1890614000.000*	266161274.5	0
During Global financial Crisis	Pre Global financial crisis	833256666.667*	307336566.9	0.022
	Post Global financial crisis	-1057357333.333*	307336566.9	0.006
Post Global financial crisis	Pre Global financial crisis	1890614000.000*	266161274.5	0
	During Global financial Crisis	1057357333.333*	307336566.9	0.006

* The mean difference is significant at the 0.05 level.

The figure below shows the foreign aid inflows trend between the three global financial crisis periods in Kenya.

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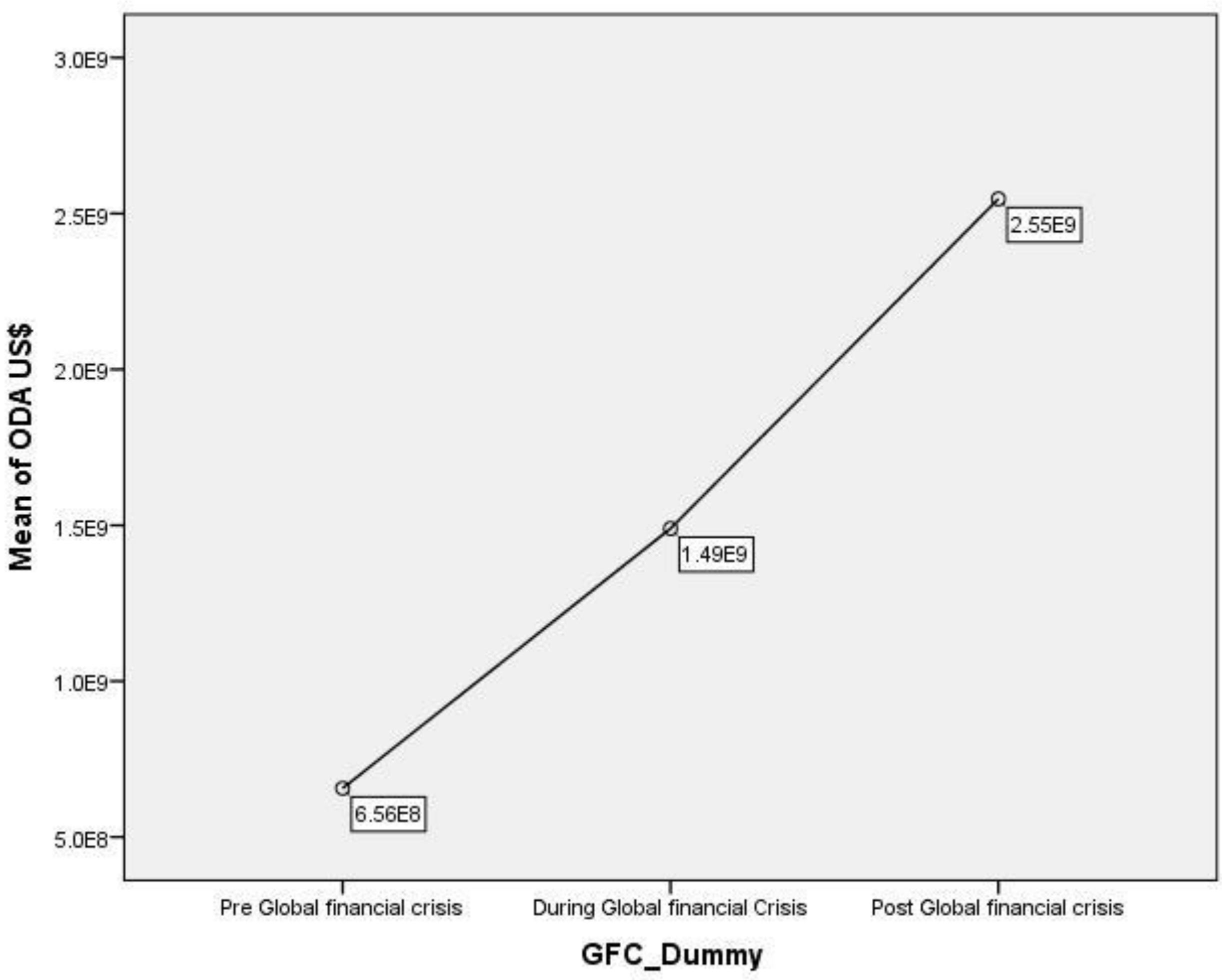

Source: Author (2016)

Figure 2: Foreign Aid Inflows Trend between the three Global financial crisis periods

5.0 DISCUSSION CONCLUSIONS AND RECOMMENDATIONS

5.1 Discussion

The objective was to determine how the financial crisis of 2008 impacted foreign aid inflows to government as well as non-governmental organizations. The analysis of variance results showed that there was a statistically significant relationship between global financial crisis and foreign aid inflows to Kenya as supported by a p value of 0.000 and an F-statistic of 25.31. This implies that global financial crisis influenced the amount of foreign aid inflows to Kenya.

A post hoc tests analysis results also revealed a significant difference in foreign aid inflows to Kenya between the regimes as supported by a p value of 0.000. This implies that different global financial crisis periods influence the inflows of foreign aid differently.

5.2 Conclusions

Based on the findings the study concluded that global financial crisis influenced the foreign aid inflows to Kenya. This can be explained by the analysis of variance results which showed a significant relationship between global financial crisis and foreign aid inflows. The findings further indicated that the foreign aid inflows were highest after the global financial crisis. Further, the findings revealed a decrease in foreign aid inflows to Kenya during the global financial crisis period.

5.3 Recommendations

Governments should invest the foreign aid inflows into broader economic programs such as eradication of poverty and health improvement. This will boost the donors' confidence that their support is being appreciated by the recipient countries.

5.4 Areas for Further Studies

The study sought to understand the determinants of foreign aid inflows to Kenya. In particular, the study focused on global financial crisis as the independent variable only, thus area for further studies could consider other variables that affect foreign aid inflows.

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