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To cite this article: Stephen P. Heyneman (2005) Foreign Aid to Education: Recent U.S. Initiatives-Background, Risks, and Prospects, Peabody Journal of Education, 80:1, 107-119, DOI: [10.1207/S15327930pje8001\\_8](https://doi.org/10.1207/S15327930pje8001_8)

To link to this article: [http://dx.doi.org/10.1207/S15327930pje8001\\_8](http://dx.doi.org/10.1207/S15327930pje8001_8)



Published online: 18 Nov 2009.



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# Foreign Aid to Education: Recent U.S. Initiatives— Background, Risks, and Prospects

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The Millennium Challenge Account (MCA) is a commitment of the United States to raise its grant aid by a factor of 50% over the next 3 years and will result in a \$5 billion annual increase over current foreign aid levels. Many other countries and multinational development assistance agencies will be asked to help cofinance this new account, and their participation would augment this original proposal from the United States. The MCA offers the opportunity for a quantum change in the prospects for peace, stability, and the alleviation of poverty. However, will it work? This article suggests that the MCA will work only if it addresses several important dilemmas in the nature of foreign aid conditionality and the terms of reference of foreign aid organizations.

Foreign aid has become institutionalized since World War II, and today it is a normal part of political and social relationships among nations. Questions have been raised about its effectiveness and continuing need. Questions have also been raised about its terms, conditions, and purposes. Over the last decade, foreign aid has been on the decline, but in 2002, the U.S. State Department announced the Millennium Challenge Account

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(MCA), with the intention to increase the total world level of foreign aid by 50% over the next 3 years; a \$5 billion dollar annual increase over the \$10 billion the United States currently allocated annually by donor nations. Many other countries and multinational development assistance agencies have been asked to help cofinance this new account, and their participation would augment this original proposal from the United States. In sum, the MCA offers the opportunity for a quantum change in the prospects for peace, stability, and the alleviation of poverty. However, will it work?

This article reviews the different kinds and mechanisms of official development assistance (ODA) to developing countries and summarizes some of the lessons learned over the last half century of experience with foreign aid in general, and for education in particular. This article suggests that the MCA will work if it addresses several important dilemmas in the nature of conditionality and the terms of reference of foreign aid organizations.

### Foreign Aid Background

Foreign aid flows through several different categories of organizations. There are *multilateral organizations*, such as the United Nations and the World Bank. Their mandates differ. Some are permitted to grant project monies and do not need to be repaid (UN organizations); others (the World Bank, the International Monetary Fund, and the regional development banks) loan monies that need to be repaid.<sup>1</sup> Some multilateral organizations are governed by the principle of one nation—one vote (such as the General Assembly and most UN agencies); others (the World Bank, the International Monetary Fund, and the regional development banks) are governed by a proportion of equity shares purchased by individual nations. The key-defining factor of all multilateral organizations is that many national owners govern them; no single nation controls them.

*Bilateral organizations* are those whose development projects are arranged country by country. The U.S. Agency for International Development is the official bilateral aid organization of the U.S. government, but every donor country has a similar agency that makes similar project arrangements.<sup>2</sup>

<sup>1</sup>The World Bank, the Inter-American Development Bank, and the Asian Development Bank all have "soft loan" programs for the poorest countries where the interest rate is less than 1%, the grace period is about 6 years, and the period of amortization is 30 years. Depending on the rate of inflation, these loans are the equivalent of a 75% grant.

<sup>2</sup>*Official development assistance* is defined as contributions of a nation to both its multilateral and its bilateral agencies. The key difference is that through the latter, the donor controls the direction and purpose of its aid, whereas with the former, the direction is decided as a consensus among the other member states.

*Private sector organizations* are also active and come in two categories: Nongovernmental organizations (NGOs) and profit-seeking organizations (commercial enterprises). The United States is the leading nation in charitable donations to developing countries (\$4 billion in 2000). However, it is the commercial sector that accounts for the largest flow of development capital. Between 1997 and 2000, U.S. businesses invested an average of \$36 billion annually in developing countries. Moreover, what is true for the United States is true for industrialized nations, generally. Approximately 62.5% of all capital flows to developing countries derive from private investment, as opposed to 36% from foreign aid (see Table 1).

Two factors characterize the foreign aid of the United States. At \$11.4 billion, it is the largest single source of foreign aid. Nevertheless, as a proportion of the economy, foreign aid from the United States is lower than many other industrialized nations. As a percentage of the economy, foreign aid from Western Europe is three times (.33%) as large as from the United States (.11%; see Table 2).

Of U.S. foreign aid, only about 3% is allocated to education, about one half the average for donor countries (see Table 3). Eight percent of U.S. for-

Table 1  
*Net Resource Flows to Developing Countries (2001)*

<i>Sources</i>	<i>%</i>
Official development assistance (foreign aid)	36.0
Private investment	62.5
Export credits	1.5
Total	100.0

*Note.* Source: Organization for Economic Cooperation and Development (2002).

Table 2  
*Foreign Aid (2001)*

<i>Source</i>	<i>\$ in Billions</i>	<i>% of GNI</i>
U.S.	11.4	.11
DAC total	52.3	.22
Of which European Union	26.3	.33

*Note.* Source: Organization for Economic Cooperation and Development (2002). GNI = gross national income; DAC = Development Assistance Committee of the Organization for Economic Cooperation and Development, consisting of donor countries.

Table 3

*Sector Allocation of Foreign Aid: United States and all DAC Countries (2001)*

<i>Sector</i>	<i>% U.S.</i>	<i>% DAC Countries</i>
Education	3.3	8.6
Health	4.4	4.1
Population	8.5	2.7
Water supply	4.7	4.8
Government and civil society	13.3	6.8
Other social infrastructure	11.3	5.4
Economic infrastructure	3.6	14.9
Agriculture	3.7	6.7
Industry	0.7	1.4
Trade and tourism	2.0	0.6
Multisector	3.9	7.2
Program assistance	19.3	6.8
Debt relief	1.3	9.8
Emergency aid	11.8	7.1
Administration	8.2	6.5
Unspecified	—	6.6
Total	100.0	100.0

*Note.* Source: Organization for Economic Cooperation and Development (2002). DAC = Development Assistance Committee of the Organization for Economic Cooperation and Development, consisting of donor countries.

eign aid is allocated to population, 14% to government and civil society, and 19% to program assistance, which often underpin economic and financial sector adjustment.<sup>3</sup>

### Background

Awarded the Nobel Prize for his pioneering work on human capital, T. W. Schultz (1981) had this to say about foreign aid:

The United States has long been a donor of various forms of aid, but the economics of aid is beset by puzzles. Why was the aid provided by the Marshall Plan successful although it was available for only a few years? Why was the large amount of aid to low-income countries since WWII been much less successful? Why did the Point Four Latin American Aid

<sup>3</sup>It has sometimes been argued that previous debt should be forgiven. Between 1990 and 1992, donor nations forgave \$5.287 billion dollars; 75% of which was forgiven by the United States (Organization for Economic Cooperation and Development [OECD], 2002, Table 6b).

Program contribute so little to the productivity in agriculture? Why have private foundations and a large number of international donor agencies had very limited success in improving the economic environment and the schooling of farm people in low-income countries? (p. 123)

His frustration is understandable. As a systematic endeavor, foreign aid was a creation of the post-WWII challenge. Quite naturally, the first priority was on infrastructure (bridges, dams, railroads, highways, and ports) because that was the most obvious of the war's destruction both in Europe and Asia. However, the specialized development assistance agencies created during the war, such as the International Bank for Reconstruction and Development, quickly encountered problems that were not by nature infrastructural. These included industry and agriculture in areas of the world free of war devastation and focused on development rather than reconstruction. The problem was that these large and well-intended organizations were terribly sluggish to change their focus to meet their new clients. They continued to place priority on infrastructure in those areas of the world that had relatively low levels of human capital, weak public institutions, few democratic traditions, and high levels of inefficiency. It was this misalignment that caused so much of Schultz's (1981) frustration and impatience with foreign aid.

The struggle to place human capital on the agenda of international development assistance agencies required 3 decades of argumentation and went through at least two distinct stages (Heyneman, 1999a). The first stage required the use of the economic models popular in that era, known as *manpower forecasting*. Widely employed in the Soviet Union and other planned economies, the technique utilized "gaps" in levels of completed education by particular working groups, manual laborers, and technicians in particular. It was thought that educational investments could be justified where gaps could be identified. There were two problems with using this technique. The complexities of what workers needed to actually know changed rapidly, rendering earlier assumptions about manpower requirements irrelevant. Moreover, techniques of manpower forecasting do not include measures of costs or benefits; and, as a result, foreign aid programs in the 1960s and 1970s were deeply distorted. Much of the aid was limited to vocational and technical education, the most expensive part of the education sector with skills in least demand; thus wasting much of the foreign aid to education during that era (Heyneman, 2003b).

The second stage included the use of several techniques, which Schultz (1981) helped pioneer, through national growth models and the estimation of costs and earnings over a working lifetime to individuals who had completed different levels of education. By using the former, one could calcu-

late the portion of a nation's economic growth explainable by various attributes such as the size of its land, labor force, capital, and the quality its workforce. In essence, it became clear in the 1960s and 1970s that a large portion of a nation's economic growth could be attributed to the quality of its labor force measured by the expansion of education and health.

Through the second, one could estimate the rates of return to educational investments, either from the perspective of an individual or from the perspective of a society, by comparison to investments in infrastructure or other uses of capital. Several generalizations emerged from this: (a) The rates of return to investments in education were greater in the lower income countries, and (b) the rates of return were greatest in basic education as opposed to higher education. These findings led to the consensus behind the initiatives for basic education and public health in the 1980s (Heyneman, 1995, 1997).

Much has changed since the Cold War rivalry ended, but one of the most important changes has been with the factors that affect motivation. Foreign assistance is no longer justified on the basis of competition between East and West, and the effect of this has reduced the size of the American commitment. American reductions in foreign aid have been criticized in many parts of Europe and Asia. How could a nation that precipitated the foreign aid trend after WWII become so self-absorbed?

However, what many Europeans may not realize is that reductions in foreign aid have not been limited to the United States. By the mid-1990s, 16 of the 21 donor countries in Europe, North America, and Asia had reduced foreign aid as a proportion of gross domestic product (World Bank, 1996, p. 13). Between 1996 and 1997, Sweden reduced its foreign aid by 5.9%; Germany by 11%; the United States by 35%; and Italy by 45% (OECD, 2002). From the years 1998 to 2001, total ODA declined by 23% (OECD, 2002, Table 1).

Why has foreign aid declined? In industrialized nations, voting publics are getting older and are concerned with issues of pensions, health insurance, and personal safety. However, there have been other questions about the nature of foreign aid and its effectiveness. Many also ask why we should continue to finance the needs of poor countries when many of the leaders of those countries are corrupt. Does it make sense for the struggling farmer in Sweden or Ohio to sacrifice so that a dictator can use the national treasury as his own personal bank account? In many instances, nations spend their monies on armaments and waste foreign aid on superfluous conflicts in which poor people suffer. Political support for foreign aid is affected by the fact that some of the same nations that suffer from periodic starvation are also those with prominent armaments, dastardly dictators, and horrible human's rights records.

Then there are questions about the development assistance agencies themselves. According to one congressional report, the functions greatly overlap; over one half of the projects have failed and often have been directed to the countries for reasons of political advantage rather than for principles of economics (International Financial Institutions Advisory Commission, 2000).

Why has aid failed? The research would suggest that aid has failed because it was targeted on countries that had two characteristics: They were comparatively rich anyway and did not need it or their policies were hopelessly mired in distortions (Dollar & Pritchett, 1998). Where has all the aid gone? By some estimations, aid has simply supplanted normal expenditures, allowing local governments to use aid for what they would have spent money on anyway, simply shifting the increments to other budget categories with low poverty or economic impact (Shantayanan, 1998). So persistent have these challenges been that many feel that the international donor agencies themselves should be restructured and that aid might well be delivered through NGOs instead of official governmental agencies. Such restructuring may not be necessary. It may be possible to increase aid and to increase the economic and social impact of aid. It may be possible for taxpayers in the United States and other industrialized societies, 10 years from now, to look back and say, "We did a good job. We made the right choice."

### MCA: Its Rationale and Its Dilemmas

There are three underlying reasons for the MCA. The first is the consensus that some aid has worked extraordinarily well, and more important, we think we know why. First in importance is the large picture. Aid cannot be effective without an overall regime in which it is "allowed to work." By some estimates, this can be reduced to fiscal balance, low inflation, openness to international markets, intelligent property rights, and strong public institutions with a history of low corruption. The thinking now is that a nation that cannot put effective development policies in place is unlikely to make effective use of foreign aid (Burnside & Dollar, 1998).

Apart from the large macropolicy picture, there is also a consensus surrounding what aid content would *not* work. As Schultz (1981) pointed out, aid to physical infrastructure duplicates what the private sector can supply more efficiently and often consists of palace-inspired prestige projects. Aid in kind is not significantly different from a nation that dumps its surplus (such as grain) on other parts of the world.<sup>4</sup> This inhibits local farmers and

<sup>4</sup>In 2001, U.S. food shipments to developing countries accounted for 11% of the overall total aid, three times the level of the average donor country (OECD, 2002, Table 19).

distorts incentives in the donor country. Aid cannot work if distortions originate in the donor country. For example, from a public finance point of view, it is counterproductive for taxpayers in the United States to support peanut prices in Georgia and at the same time finance assistance to peanut farmers in Africa who will not be able to export because of the U.S. domestic price supports. A level playing field should be treated as a universal concept. For the MCA to be effective, each donor country will need to understand that its commitment to foreign aid will require domestic policy reforms too.

Aid from foundations has sometimes been directed to personal and private interests. One example is the Kellogg foundation's aid to agriculture, which has been limited by its charter to extension service, an American invention that could not transfer effectively without the land grant universities and other sources of technical information (Schultz, 1981, p. 126). Aid administered from bilateral organizations (those whose programs are government to government) is frequently directed to countries with domestic political importance and burdened by micromanagement from domestic legislation. Of the U.S. foreign aid in 2003, 45% was allocated to one region. In fact, four countries (Israel, Egypt, Jordan, and the West Bank and Gaza) accounted for 35% of all U.S. foreign aid, more than all the countries of Africa and Latin America together (Table 4). Many now seem to agree: Under these circumstances, aid cannot be expected to have long-term impact.

Third, we think we know what kind of aid works best. If nested within nations with supportive economic and social principles, aid will work. However, the purpose of aid is equally important. Public aid should be targeted to supporting public functions and public goods essentially in public

Table 4  
*U.S. Foreign Aid by Region (2003)*

<i>Region</i>	<i>\$ in Billions</i>	<i>%</i>
Africa	1.3	19.0
Europe and Eurasia	1.6	23.0
Latin American and Caribbean	0.5	7.2
Asia and the Near East	3.1	45.0
Israel alone	1.0	15.0
Egypt alone	0.7	10.0
Jordan alone	0.2	3.0
West Bank and Gaza alone	0.5	7.0
Total for four countries	2.4	35.0
Other	0.4	5.7
Total	6.9	100.0

*Note.* Source: U.S. Agency for International Development (2003).

health and education. Aid should support the policies that can address the problems of health status in terms of infectious disease and poor behavior in terms of dangerous sexual practices, smoking, and the abuse of alcohol. In the field of education with rates of per pupil expenditure differing from one country to another by a factor of 1:300, an investment in primary education for girls and for simple goods and services such as textbooks, in particular, generates the highest economic returns on which data are available. There is also good evidence that an investment in education changes behavior. Farmers make more intelligent choices among a complex set of input choices; families make more intelligent choices in terms of family size, health practices, and choices of investment.

Therefore, the MCA offers the world an opportunity to turn the page in the field of foreign aid. It offers the opportunity to learn from our experiences and to offer a realistic promise for a better world. So what are the major challenges facing the MCA?

The MCA has three underlying dilemmas. The first is that there is no commitment to stop allocating foreign aid for reasons of domestic benefit or geopolitical considerations having little to do with poverty. The problems are known, but there is little discussion of their organizational ramifications. Are donor nations likely to cease allocating foreign aid to political despots whom they need for political reasons? Is the international community ready to streamline the International Monetary Fund, the World Bank, and the regional development banks so that their functions do not overlap?

The second problem is the traditional "chicken and egg" question. Of course it makes sense to allocate aid to countries that institute macro-reforms. However, past foreign aid has not been sufficient incentive to get countries to make the necessary political and social changes. The number of countries eligible for foreign assistance under MCA rules might be reduced to a tiny percentage of poor countries, leaving hundreds of millions of deserving people untouched by this new program. Current aid has not been able to effectively address world poverty. Are nations that do not qualify for MCA to be bypassed? On the other hand, if aid is advanced on the basis of need and not effectiveness, does this not encourage "moral hazard?" Would local political leaders engage in risky economic behavior on grounds that aid would arrive even after their mistakes?

The third problem is internal to the health and education sectors. International aid agencies like to think that they have discovered what went wrong in the macroenvironment and within the health and education sectors too. They propose to have countries allocate public resources to public health and not to curative care, to primary education and not higher education. The problem is that these recommendations have a long history of creating their own distortions and project failures. Based on the advice of

international agencies, project and policy failure has been evident since the 1960s (Bennell, 1996; Colclough, 1996; Heyneman, 2003a, 2003b, 2003c). The question arises then as to who is responsible. Because all projects, even using grant aid, have local cofinancing requirements, when the failure of a project is due to mistakes made by the development assistance agency, does the country get its money back? Is there a court to which a country can appeal for damages? Within development assistance agencies, who takes responsibility for failures? Are senior staff relieved of their duties when they are responsible for wasteful project designs? No.

### Conclusion

The solution to designing successful sectoral strategy lies in three reforms. First, international development agencies need to strengthen the access of developing countries to data on education and health. Currently, the collection and quality control mechanisms are deeply flawed (Heyneman, 1999b), and this has long-term negative consequences for developing countries. The proposed re-entry into the United Nations Educational, Scientific, and Cultural Organization (UNESCO) and leadership in some arenas of education statistics provides an excellent opportunity for the United States to help guide with a sense of professional purpose (Heyneman, 2003b). It is true that the United States has serious education problems, but it is also true that some assets of American education are of significant value to the world. Those include how U.S. education incorporates (through school boards and other consensus-building mechanisms) diverse ethnic interests into a consensus over civics and other sensitive curricula (Heyneman, 1998). Clearly, some of the new MCA resources need to be allocated to helping poor countries raise the level of quality of education and health statistics.

Second, nations need to make their own choices over what kind of education and health they wish to invest in, and their choices should not be determined by the source of the financing (Alexander, 2001). Basic research, doctoral-level higher education, new pharmaceuticals, free education, and free health care should be legitimate uses of foreign aid. If a nation has the courage and the foresight to put its macroeconomic house in order and achieve democratic public institutions, it should not be micromanaged about whether it invests in a university. This would require a shift away from having international agencies establish sector conditionality for aid in education and health. However, how likely is it that international development assistance agencies will refrain from establishing conditions for

sector policies while establishing tougher conditions for macroeconomic policy?

Many of the distortions (i.e., the mistakes) made by development assistance agencies in health and education stem from the fact that there is an operating monopoly over development assistance. Resources for conducting the analysis (to decide sector policy) and the resources to finance development projects are situated within the same organization. There is no public defender available to poor countries. They have no equivalent analytic representation to counter what appears in the beginning as compelling social science. As a result, poor countries cannot adequately decide on their own strategies and are vulnerable to agreeing to principles to which they do not adhere and to which the development assistance agency in fact may change.

On the other hand, there are three ways in which this monopoly over policy and program can be effectively addressed:

- Shifting resources for doing policy analysis to developing countries and allowing them to decide what to analyze and who (decided by open competitive bidding) should perform the analyses.
- Having the World Bank continue to sponsor policy analyses but having operational decisions over project monies decided by the regional development banks.
- Having education and health policy designed by the agencies within the United Nations (such as UNESCO and the World Health Organization) instead of the agencies that provide project monies.

Third, to withdraw from the field of sector conditionality does not mean that the international community has no legitimate role in asking the question about the purpose of education. By allowing so much new money to flow into international development education, the donor community must realize that schools and school systems can be used for ill purposes as well as good. No longer should it be acceptable for a nation to invest in a school system that exacerbates domestic social tension and threatens international political insecurity. We must recognize that as a source of international tension, inflammatory curricula are as problematic as policies that generate sudden waves of refugees, genocide, and human slavery. International agencies have taken up responsibility for monitoring trends, adjudication claims, and recommending solutions to these other issues. Perhaps through Civitas: The Institute for the Study of Civil Society and through other international civics education authorities, international agencies need to take responsibility for the danger to social cohesion posed by extremist education.

It is true that human capital concerns have traditionally concentrated on the issues of skills and technologies measured by changes in marginal productivity. However, it must be remembered that the first purpose of public education is that of social cohesion; and therefore, the success of this new MCA initiative will lie primarily not in the improved math and science scores but in the improved understanding of the prerequisites for a stable and peaceful world (Heyneman, 2000; Heyneman & Todoric-Bebic, 2000). Are international organizations able to implement these untested but legitimate purposes of foreign aid? Not without the changes suggested here.

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