Normative Perspectives on Foreign Aid

An Instrumental Variable Approach

Abstract

This research paper aims to offer a way of addressing two major criticisms leveled against foreign aid: both its alleged *ineffectiveness* and its associated lack of *legitimacy*. To this end, the paper is an exercise in policy recommendation building (1) on an ethical appraisal of what makes foreign aid policy legitimate and (2) on an econometric analysis gauging when it is effective. For the first prong, this paper argues that policy evaluation in economics, more generally, and in foreign aid, more particularly, demands the use of an array of social development metrics, in addition to GDP growth, for it to be sufficiently justified. For the second prong, the paper leverages a novel instrumental variable –based on legislative fragmentation– to determine if U.S. foreign aid is effective at all in promoting these outcomes. In turn, the findings agree with the wider literature that aid targeted at Economic Development has either insignificant or adverse effects on welfare metrics while strongly associated with rights deterioration in recipient countries. In contrast, the findings also reveal that the opposite holds true for Democratic and Educational aid. These results emphasize the need for aid reallocation, shifting away from Economic Development aid and prioritizing aid that fosters democratization and education in emerging economies.

Keywords: Welfare Economics, Global Ethics, Aid Effectiveness, Instrumental Variable.

The aid-effectiveness debate has been anything but effective, with some recent contributors apologizing for adding to the already saturated literature.[1] Likewise, I begin by apologizing for discussing, once more, a very large and yet largely inconclusive project. The need to move beyond this theoretical cul-de-sac, however, is best articulated by William Easterly for "as long as there are poor nations suffering from pestilence, oppression, and hunger… and as long as human intellectual efforts can devise ways to make them richer, the quest [for growth] must

[1] Axel Dreher and Sarah Langlotz, "Aid and growth: New evidence using an excludable instrument," *Canadian Journal of Economics/Revue Canadienne d'Économique* 53, no. 3 (2020): 1162.

go on."[2] This paper has, therefore, two primary objectives: (1) to reevaluate the methodology used to assess development assistance, one that addresses key concerns regarding its *ineffectiveness* and *illegitimacy*; and (2) to leverage a novel instrumental variable that demonstrates how, under a more legitimate policy evaluation framework, aid can be seen to be effective and can be made even more so.

Situated within the broader literature challenging GDP as the primary metric for social well-being, though within the context of foreign assistance more particularly, this paper seeks to question the commonly held view that foreign aid is ineffective at its best and harmful at its worst. More specifically, by employing an instrumental variable approach and adopting a broader spectrum of social welfare indicators, the paper suggests that aid can be made effective with a more targeted allocation toward democratic and educational purposes and away from economic development. Demonstrating that, despite widespread disappointment with development assistance, we should abstain from abandoning the project all together.

I. Effectiveness

While previous research and policymakers have most commonly used GDP per capita growth as the key metric to gauge the benefits of aid,[3] there has also been a converging consensus on aid's lack of growth effects.[4] A wide array of explanations have been proposed for this absence, including that aid's effects are too small to be identifiable by modern econometric tools,[5] their conditionality on policies or institutions,[6] their potential to distort the economy via inflationary pressures or the Dutch Disease, as well as their role in undermining political and economic incentives for long-run development policies.[7] These negative effects presumably offset any potential benefits of aid and have thus prompted a recent surge in papers studying how the effects of aid may vary across different channels of application. For instance, Bjørnskov (2019) breaks aid into aid for economic purposes, social purposes, reconstruction, and a residual category; and a similar apportionment is used by Asongu and Nwachukwu (2017). Clemens et al. (2012) specifically evaluate early-impact aid, and Rajan and Subramanian (2008) distinguish between multilateral and bilateral aid.[8] In a similar vein, this

[2] William Easterly, *The Elusive Quest for Growth,* The MIT Press (2011), xiii.

[3] Shaomeng Jia, "Foreign Aid Conditionality and Economic Growth," in *Lessons on Foreign Aid and Economic Development: Micro and Macro Perspectives*, ed. Nabamita Dutta and Claudia R. Williamson (Springer International Publishing, 2019), 13–32.

[4] Hristos Doucouliagos and Martin Paldam, "Aid effectiveness on growth: A meta study," *European journal of political economy* 24, no. 1 (2008): 1–24; Hristos Doucouliagos and Martin Paldam, "The ineffectiveness of development aid on growth: An update," *European journal of political economy* 27, no. 2 (2011): 399–404.

[5] David Roodman "Through the Looking Glass, and What OLS Found There: On Growth, Foreign Aid, and Reverse Causality" Center for Global Development Working Paper 137 (2008)

[6] Shaomeng Jia, "Foreign Aid Conditionality and Economic Growth," (2019)

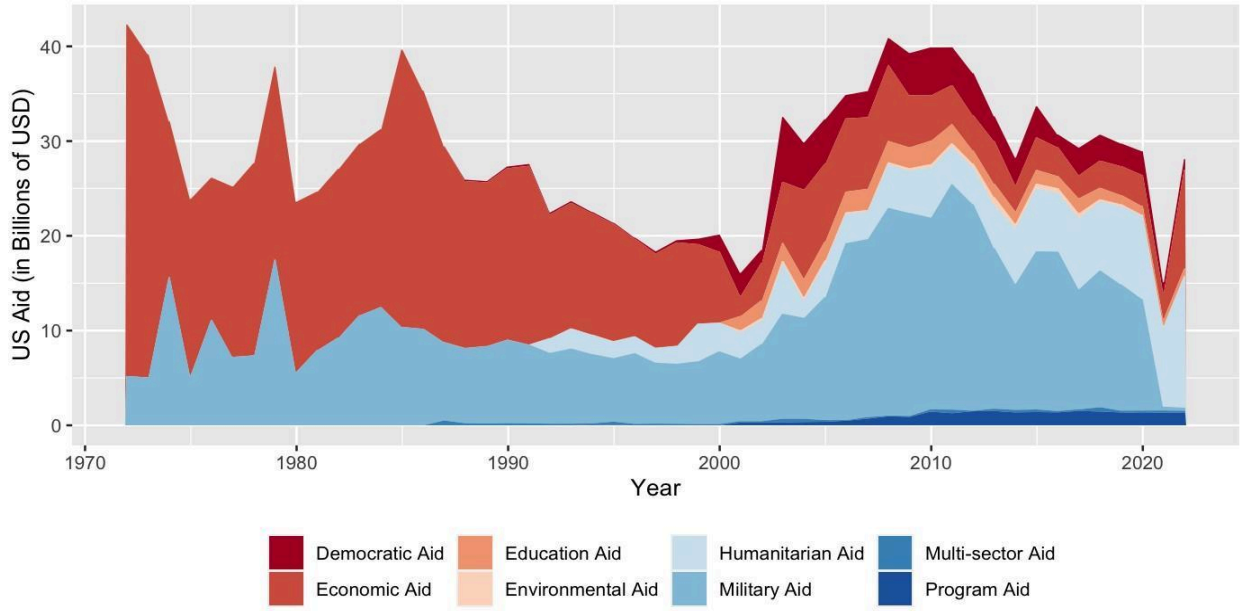
[7] William Easterly, *The Elusive Quest for Growth* (2011)

[8] Christian Bjørnskov, "Types of Foreign Aid," in *Lessons on Foreign Aid and Economic Development: Micro and Macro Perspectives*, ed. Nabamita Dutta and Claudia R. Williamson (Springer International Publishing, 2019), 33–61; Simplice A Asongu and Jacinta C Nwachukwu, "Foreign aid and inclusive development: Updated evidence from Africa, 2005–2012," *Social Science Quarterly* 98, no. 1 (2017): 282–298; Michael A Clemens et al., "Counting chickens when they hatch: Timing and the effects of aid on growth," *The Economic Journal* 122, no. 561 (2012): 590–617; Raghuram G Rajan and Arvind Subramanian, "Aid and growth: What does the cross-country evidence really show?," *The Review of economics and Statistics* 90, no. 4 (2008): 643–665.

paper falls squarely within this typological analysis but introduces a novel instrumental variable based on legislative fragmentation.

The motivation behind using an instrumental variable is to avoid problems of backward causation. In this case, given that a country's growth rates will influence its aid inflows, I use the fractionalization of the U.S. House of Representatives as a stand-in for aid, hinging on the positive association between legislative fragmentation and government expenditures,[9] –including foreign aid.[10] This approach eliminates concerns of reverse causation, as it is improbable that a foreign nation's growth rates influence the fractionalization of the U.S. legislature. Moreover, unlike all previous applications of this instrument, which studied the impact of *aggregated* aid on growth,[11] refugees,[12] or political rights,[13] this paper disaggregates aid by purpose. Notably, the approach pursued here gains relevance due to the availability of more granular data since 2001, which allows for a more comprehensive analysis of U.S. aid disaggregation, as depicted in Figure 1. This approach thus contributes significantly to understanding aid's multifaceted impact on recipient countries' welfare and informs evidence-based policy recommendations.

Figure 1 *U.S. Foreign Aid in the past 50 years*



[9] Nouriel Roubini and Jeffrey D Sachs, "Political and economic determinants of budget deficits in the industrial democracies," *European Economic Review* 33, no. 5 (1989): 903–933; Carlos G Scartascini and W Mark Crain, *The size and composition of government spending in multi-party systems* (Springer, 2021).
[10] Jeffery I Round and Matthew Odedokun, "Aid effort and its determinants," *International Review of Economics & Finance* 13, no. 3 (2004): 293–309; Viktor Brech and Niklas Potrafke, "Donor ideology and types of foreign aid," *Journal of Comparative Economics* 42, no. 1 (2014): 61–75.
[11] Dreher and Langlotz, "Aid and growth: New evidence using an excludable instrument."
[12] Axel Dreher, Andreas Fuchs, and Sarah Langlotz, "The effects of foreign aid on refugee flows," *European Economic Review* 112 (2019): 127–147.
[13] Ahmed, "Does foreign aid harm political rights? Evidence from US aid."

II. Legitimacy

The results above, indicating that aid has not evidenced growth effects, represent a best-case scenario, for it has also been suggested that aid often harms the population it seeks to benefit. For example, there is ample evidence of extensive aid directed towards autocracies —a trend that seems to be on the rise.[14] This feature can be attributed to several factors, including the view that autocracies may be in more need of development, that they are more conducive to growth, or that they may be aligned with the geopolitical interests of donor countries. Yet, regardless of its potential growth benefits, aid targeted at authoritarian regimes is manifestly a source of trade-offs, particularly when aid targeted at these regimes prevents democratization.[15] Similar issues plague other consequences of aid, particularly by the U.S., which has been shown to be positively associated with larger degrees of repression in recipient countries[16] and the prolongation of civil conflict.[17] This issue is compounded by the fact that unlike policymaking in democratic regimes, which is to some extent accountable to the will of the beneficiaries, aid policy hardly is. This presents a normative challenge for aid policy, as its justification must often rely on what donor agencies or countries interpret to be in the best interest of the recipients, which undoubtedly requires a more nuanced approach to how we evaluate aid's outcomes.

An illustrative case of the lack of normative nuance in policy recommendation was appraised in the debates over the infamous 1991 *Summers memo* where Larry Summers (the then World Bank's Chief Economist) argued that less developed countries are under-polluted claiming that "the economic logic behind dumping a load of toxic waste in the lowest-wage country is impeccable and we should face up to that."[18] And hence, informed by recent work in the philosophy of welfare economics,[19] this paper advocates for a more rigorous methodology to evaluate both the normative justifications of social welfare metrics within economics, and our derivation of policy recommendations from them. This alternative methodology underlies the need to extend this paper's instrumental variable approach beyond GDP growth to accurately identify whether aid is, in truth, effective.

III. Structure

To this end, the paper begins with the section "Legitimate Well-Being Policy," advocating for a framework that addresses aid's legitimacy concerns by incorporating a diverse range of welfare measures, one that adequately assesses its effectiveness and legitimately justifies its deployment.

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[14] William Easterly, *The Tyranny of Experts: Economists, Dictators, and the Forgotten Rights of the Poor* (New York: Basic Books, a member of the Perseus Books Group, 2021).

[15] Miguel Niño-Zarazúa et al., *Effects of Swedish and international democracy aid* [in English and Swedish], Stockholm, Sweden, December 2020.

[16] Faisal Z. Ahmed, "Foreign Aid and Repression," in *Lessons on Foreign Aid and Economic Development: Micro and Macro Perspectives*, ed. Nabamita Dutta and Claudia R. Williamson (Springer International Publishing, 2019), 187–205; Faisal Z. Ahmed, "Does foreign aid harm political rights? Evidence from US aid," *Quarterly Journal of Political Science* 11, no. 2 (2016): 183–217.

[17] Nathan Nunn and Nancy Qian, "US food aid and civil conflict," *American economic review* 104, no. 6 (2014): 1630–1666.

[18] "Furor on Memo at World Bank," *The New York Times*, February 1992.

[19] Daniel Hausman, Michael McPherson, and Debra Satz, *Economic Analysis, Moral Philosophy, and Public Policy* (Cambridge University Press, 2019).

It briefly explores the distinction between positive and normative economics and discusses the challenge economists must face in balancing objectivity with normative policy recommendations. The section "Data and the Traditional Welfare Model" clarifies the main model of welfare economics based on GDP growth and its use to evaluate aid's effectiveness. This section also introduces the instrumental variable (IV) approach employed throughout the paper. The section "Traditional Results" evaluates the results from the IV regression analysis and its policy implications, corroborating the prevailing consensus in the literature regarding the limited effectiveness of aid. Moving forward, the section "Data and Extended Welfare Models" applies the new framework advocated by this paper and introduces three additional measures—HDI growth, Political Rights, and Civil Liberties—along with their respective model specifications. Section "Extended Results" discusses the empirical results of these additional instrumental variable regressions and their policymaking implications. Lastly, "Conclusion" concludes.

Legitimate Well-Being Policy

Using GDP as a measure of national social well-being has sparked extensive and enduring debate in economics. While it serves as a convenient accounting measure for *economic* performance, the bulk of the criticism falls on its unsuitability as a measure for *social* development, broadly construed. These critiques often fall into two buckets. Firstly, GDP is faulted for leaving out important components of national well-being, such as the value-added of domestic work and volunteering, the benefits of leisure or the costs of environmental degradation, and the psychological stress of unemployment, crime, family breakdown, etc. This critique forms the basis for initiatives like Green GDP or the Genuine Progress Indicator (GPI) which advocate for *adjustments* to GDP rather than its outright dismissal.[20] The second type of criticism is more thoroughgoing, posing that GDP completely misrepresents national well-being, advocating for replacing GDP altogether as its primary measure. Specifically, even if GDP is a good proxy for the citizenry's capacity to satisfy their preferences, these critics contend that national well-being is determined by other factors such as freedom, pleasure, or other elements better captured by other indicators. This perspective underlies initiatives like the World Happiness Index by Oxford's Wellbeing Research and the Human Development Index (HDI). The details of this debate need not concern us here, yet it underscores a problem regarding the normative underpinnings of policy recommendations, which, in so far as they rely on a specific view of well-being, compromises their objectivity.

A clarification point is in order. Policy recommendations within economics may be categorized into two general types: (1) those focused on the means for obtaining a pre-established political objective (e.g., the government *should* deregulate *if* it aims to promote free markets) which are primarily concerned with the cause-effect mechanisms of policymaking, and (2) those advocating for the best way of organizing and improving the economy (e.g., we *should* promote free markets or maintain low inflation rates) often with the implicit goal of long-run economic growth. This classification roughly corresponds to the

[20] European Parliament, Policy Department: Economic and Scientific Policy, Alternative progress indicators to Gross Domestic Product (GDP) as a means towards sustainable development, by Yanne Gossens et al., IP/A/ENVI/ST/2007-10, (Brussels: 2007): 17-19, https://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOLENVI_ET%282007%29385672

distinction between positive and normative economics that is well-known in the discipline. While *positive* policy recommendations of the first kind are generally considered normatively unproblematic, even when highly controversial, it is those falling into the second category —*normative* policy recommendations—, which pose significant challenges in virtue of their value-ladeness. In this way, the paper is not concerned with explaining the causes for why foreign aid has been distributed in one way or another –it may as well be a function of U.S. business activity—, but rather with the justifications guiding how it is *best* allocated. For even when aiming to promote long-run economic growth, these judgments must often rely on substantive value judgments, which may appear arbitrary, unfounded, or biased, resulting in two potential risks —one theoretical and the other practical— from which legitimacy concerns sprout.

At a theoretical level, *normative* policy recommendations threaten objectivity, as was mentioned above —which is a crucial theoretical virtue for any scientific project, and for Economics, this is no exception. In fact, the quest for an objective and value-free Economics has been a long-searched and hotly debated topic,[21] some even identify it as a core axiom of the discipline.[22] While some well-known economists such as Lionel Robbins have called to rid the field of all normativity,[23] others like Amartya Sen have fully embraced a normative approach.[24] Yet, the aspiration to rid the field of value judgements is an ultimately flawed endeavor at least when it comes to welfare economics which necessarily presupposes at least one normative premise when identifying well-being with some fact or property, be it preferences, pleasure, happiness, etc.[25] To say that a policy will make people better off, perhaps by increasing GDP per capita, is often implicitly referencing that this policy will satisfy people's preferences, presumably through higher disposable income; yet equating well-being with preference-satisfaction is to make a substantive value judgement in itself. Moreover, this assumption is also one of the avenues through which normative policy recommendations pose a secondary and practical problem: paternalism. Justifying a certain end or policy based on a particular conception of well-being can lead to the coercive imposition of this view over others.[26] This is particularly salient in the context of foreign aid where the beneficiaries may not have a say in how aid is distributed, especially in autocratic

[21] Stavros A Drakopoulos, "Origins and development of the trend toward value-free economics," *Journal of the History of Economic Thought* 19, no. 2 (1997): 286–300.
[22] Aleksander Ostapiuk, *The Eclipse of Value-Free Economics. The concept of multiple self versus homo economicus* (Wydawnictwo Uniwersytetu Ekonomicznego we Wroc lawiu, 2021); Aleksander Ostapiuk, "Value-free paradise is lost. Economists could learn from artists," *Annales. Etyka w z˙yciu gospodarczym* 23, no. 4 (2020): 7–33.
[23] Lionel Robbins, "The nature and significance of economic science," *The philosophy of economics: An anthology* 1 (1932): 73–99.
[24] Amartya Sen, *On Ethics and Economics* (Oxford and New York: Basil Blackwell, 1987).
[25] Igor Wysocki, "Justice vis `a vis welfare: how Austrian welfare economics should fit in the Austrolibertarian framework," *Economia Politica* 40, no. 2 (2023): 445–467. Even the Austrian School's programmatic Wertfreiheit (i.e., value-freedom) is not exempt from this normative commitment. At their most robust, defenses of Austrian Welfare Economics explicitly rely on a normative framework by equating actual preference satisfaction with personal benefit see Alan P Hamlin and Robert Sugden, "On the possibility of Austrian welfare economics," in *Austrian economics: Tensions and new directions* (Springer, 1992), 193–214.
[26] Jonathan Quong, *Liberalism without Perfection* (Oxford University Press, 2010); John Rawls, *Political Liberalism* (Columbia University Press, 1993).

regimes. The pressing question then becomes: how can objectivity be salvaged if value judgments cannot be avoided?

This paper proposes an alternative interpretation of objectivity —one where this notion is best understood as neutrality between value judgments rather than their absence. This approach closely aligns with Haybron & Tiberius' concept of "pragmatic subjectivism" contending that "policies aimed at bettering people's lives must do so according to the beneficiaries' own standards."[27] Accordingly, it is not permissible for states to impose an external standard of well-being on their citizens and must be agnostic regarding the correct view of well-being. For example, given that philosopher Peter Singer is a hedonic utilitarian, and thus believes that well-being is determined by pleasure,[28] the government is only justified to promote policies aimed at enhancing his well-being by appealing to hedonic considerations (e.g., measured through Kahneman's U-index rather than traditional cost-benefit analysis). However, views of well-being are expected to vary extremely within a given country, not to mention between nations, and we may well wonder how policies will be able to satisfy such high criteria for everyone. Even if assuming that within democracies, this problem is practically solved through democratic decision-making, international policy lacks such mechanisms. This obstacle, however, does not warrant resignation; rather, it only requires us to adjust the way we assess policy. Chiefly, the view considered in this paper is that only those policies showing no negative effects on any measure of well-being and yet in accordance with a variety of conceptions of welfare ought to be seriously considered; in this way, we avoid imposing external standards on citizens and mitigate (though not enough to eliminate) inter-state paternalism by ensuring a wide span of normative frameworks are considered. By adopting a stance of agnosticism over the correct view of well-being and employing a diverse array of measures of social outcomes, we can craft policy recommendations that are neutral among competing moral frameworks and thus can be finally objective and legitimate on an international scale. Now, before turning to how this may look in practice –which is the aim of the section "Extended Welfare Models"—, let us first evaluate U.S. foreign aid from the most common moral framework used for policy recommendations: Gross Domestic Product.

[27] Daniel M. Haybron and Valerie Tiberius, "Well-Being Policy: What Standard of Well-Being?" *Journal of the American Philosophical Association* 1, no. 4 (2015): 719.

[28] Katarzyna de Lazari-Radek and Peter Singer, *The Point of View of the Universe: Sidgwick and Contemporary Ethics* (Oxford University Press, May 2014)

1 Data and the Standard Welfare Model

1.1 Standard Normative Model

In order to understand why the literature treats Gross Domestic Product (GDP) and GDP per capita as the key benchmark for policy evaluation, we can refer to the characterization of the default position of welfare economics by Haussman et al. (2019) in Table 1.[29]

Table 1 The moral framework of welfare economics

1. What should economists appraise?
   a. *Outcomes*
   b. Processes
2. What method(s) of appraisal should economists use?
   a. *Single method of appraisal*
   b. Multiple ethical perspectives, depending on the problem
3. What matters about outcomes?
   a. *Consequences for individuals*
   b. Consequences for groups, or the environment
4. Which outcomes for individuals matter?
   a. *Welfare*
   b. Freedom
   c. Rights
   d. Justice
5. What is welfare?
   a. *The satisfaction of preferences*
   b. Some mental state (e.g., happiness, pleasure)
   c. "Objective" goods (e.g., achievements, personal relations, health)

Source: The table is taken verbatim from Haussman et al., "Economic Analysis, Moral Philosophy, and Public Policy" (2019), p.26

From this table, we may conclude that the default position of welfare economics holds the following premise.

(1) For any policy X, if X promotes/hinders the satisfaction of people's preferences, then X should be adopted/discarded.

If, additionally, we hold the reasonable empirical premise that income is a good proxy for preference satisfaction, we can see why governments ought to promote both GDP per capita, representing the average income of citizens, and its growth (which displays structural rather than incidental changes). A similar reasoning often underlies the justification of free and efficient markets and their Pareto-superior consequences. And though simplified, this approach also sheds light on the potential rationale behind aid agencies' involvement in sponsoring authoritarian governments. Instead of uncritically accepting the potential economic benefits of autocracies, their justification hinges on a normative commitment to satisfy citizens' preferences. Consequently, if aiding an illiberal or undemocratic country demonstrates a positive impact on GDP per capita growth, supporting such a government

[29] Hausman, McPherson, and Satz, *Economic Analysis, Moral Philosophy, and Public Policy*

promotes the well-being of its citizens, which is ultimately our primary concern. As a result, the following conclusion naturally emerges from this line of reasoning.

(2) Foreign aid should be allocated in a way that promotes GDP per capita growth.

For this purpose, we must first discern which types of aid foster economic growth. For instance, we may expect that whereas humanitarian assistance may not necessarily contribute to a country's long-term productive capacity, aid specifically targeted towards Economic Development stands a better chance. To this, we now turn.

1.2 Standard Empirical Model

I use data from 112 countries between 1972 and 2013. The summary statistics are reported in the appendix (Supplementary Table A1). To investigate which kinds of aid are most conducive for GDP per capita growth, while avoiding potentially biased OLS estimates, I consider the following two-stage IV system:

$$\hat{Aid}_{i,t} = \alpha_1\left(FRAC_t \times P_i\right) + \alpha_2 X_{i,t} + \eta_i + \tau_t + u_{i,t} \quad \text{(I)}$$

$$GrowthGDP_{i,t} = \beta_1 \hat{Aid}_{i,t-m} + \beta_2 X_{i,t} + \eta_i + \tau_t + \epsilon_{i,t} \quad \text{(II)}$$

That is, ultimately, I explain the growth of a given country's GDP per capita ($GrowthGDP_{i,t}$) by a set of (instrumented) categories of aid ($\hat{Aid}_{i,t}$) received in a previous period *t*. I also consider country-fixed effects (η) and year-fixed effects (τ). The former accounts for time-invariant country-specific factors (e.g., geography), and the latter allows me to control for the influence of global phenomena (e.g., the end of the Cold War). Significantly, as I will discuss later, these fixed effects will solve the endogeneity that may arise from the instrumental variable. I also include a set of controls ($\mathbf{X_{i,t}}$) taken from Burnside and Dollar (2000), which has become standard in the literature.[30] I will describe these in more detail below. Finally, standard errors are clustered at the recipient country level.

In line with existing literature,[31] $GrowthGDP_{i,t}$ is measured as the average annual real GDP per capita growth of recipient country *i* over a four-year period *t*. This approach enables us to capture long-term effects on growth while mitigating the impact of business-cycle volatility and random noise.[32] Data to construct the Growth variable is sourced from the World

[30] Craig Burnside and David Dollar, "Aid, policies, and growth," *American economic review* 90, no. 4 (2000): 847–868; Jia, "Foreign Aid Conditionality and Economic Growth"; Dreher and Langlotz, "Aid and growth: New evidence using an excludable instrument."

[31] Dreher and Langlotz, "Aid and growth: New evidence using an excludable instrument"; Jun-ki Park, Deockhyun Ryu, and Keun Lee, "What determines the economic size of a nation in the world: Determinants of a nation's share in world GDP vs. per capita GDP," *Structural Change and Economic Dynamics* 51 (2019): 203–214.

[32] Bjørnskov, "Types of Foreign Aid."

Development Indicators at the World Bank's DataBank (2021). $\hat{Aid}_{i,t}$ (measured in logarithmic units $log(1 + \hat{Aid}_{i,t})$ to account for non-linearity) acts as a stand-in for different aid categories. The categorization follows the U.S. Office of Foreign Assistance's Standardized Program Structure and Definitions (SPSD), which breaks down aid into the following categories: "Peace and Security," "Democracy, Human Rights, and Governance," "Health," "Education and Social Services," "Economic Development," "Environment," "Humanitarian Assistance," "Program Support," and "Multi-sector." For the purpose of this study, however, I only focus on analyzing the potential effects of Military Aid (i.e., Peace and Security), Democratic Aid (i.e., Democracy, Human Rights, and Governance), Humanitarian Aid (i.e., Humanitarian Assistance), Education Aid (i.e., Education and Social Services) and Health Aid. Data for these variables is obtained from The US Foreign Aid Explorer (FAE) at ForeignAssistance.gov.

Controls. I follow Dreher and Langlotz's (2020) permutation of the controls originally introduced by Burnside and Dollar (2000). First, I control for *initial (logged) GDP per capita*, measured as the logarithm of GDP per capita in the first year of each four-year period. The data comes from the World Bank's World Development Indicators (2023). Second, I control for the average number of *assassinations* in country *i* at period *t* which is found in the Cross-National Time Series Data Archive by Banks and Wilson (2023). Third, I control for the interaction between assassinations and *ethnolinguistic fractionalization*. The data come from The Historical Index of Ethnic Fractionalization Dataset by Drazanova (2019). Lastly, instead of using M2/GDP (lagged), as Dreher and Langlotz do, which would exclude most of my observations, I use broad money (as a percent of GDP) lagged by one period as a measure of the money supply in the recipient country. The data come from the World Bank's DataBank (2023).

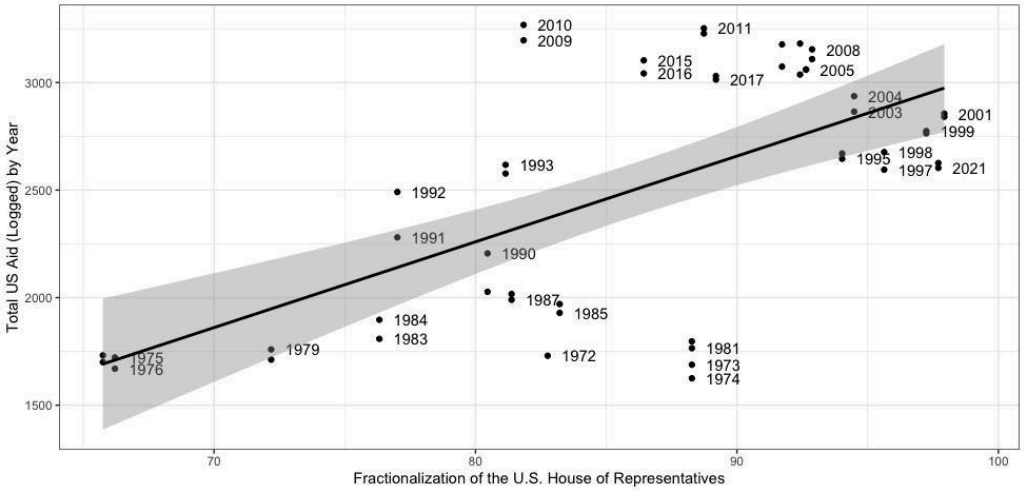
Instrument construction. The instrumental variable ($FRAC_t \times P_i$) is constructed as the interaction between the legislative fractionalization of the U.S. House of Representatives —$FRAC_t$— and a time-invariant variable for the probability of receiving aid from the U.S. —P_i— so that the resulting interaction varies across time and space. Following Ahmed (2019), $FRAC_t$ is given by $\left(1 - \frac{\left|DEMOCRAT_t - REPUBLICAN_t\right|}{435}\right) \times 100$ where the closer the value is to 100 the higher degree of fractionalization in the House of Representatives. P_i is given by $\frac{1}{41} \sum_{t=1972}^{2013} p_{i,t}$ where $p_{i,t}$ is equal to 1 if a country receives aid in a given year *t* and zero otherwise. Thus, the instrumental variable takes the following form: $IV = FRAC_t \times P_i$

Instrument Exogeneity. While it seems unlikely that the growth of an aid recipient country has any bearing on the fractionalization of the US legislature —which rather seems to be determined by domestic politics— one may worry that it might affect the probability of receiving aid. However, such potential exogeneity is controlled for by including country fixed effects given that the probability of receiving aid P_i is a time-invariant characteristic of each

country. A similar reasoning holds of the legislative fractionalization —$FRAC_t$—of the House and time fixed effects. As a result, the interaction term becomes exogenous.[33]

Instrument Relevance. The relevance of the instrument relies on two mechanisms. First, it has been shown that the fractionalization of the legislature is associated with an increase of government's expenditures.[34] Second, greater expenditure is associated with a greater level of foreign aid appropriations.[35] In sum, fractionalization affects expenditure and expenditure includes aid. The positive association between the two can observed in Figure 2.

*Figure SEQ Figure * ARABIC 2 Fractionalization of the House and Aid*



2 Standard Model Results

2.1 Empirical Results

Table 2, displaying the results of the first-stage regression model (1), shows that the instrumental variable (*IV*) is a reliable determinant of U.S. aid for 112 recipient nations. Consistent with Ahmed (2019), the negative association between U.S. aid obligations and the

[33] Nunn and Qian, "US food aid and civil conflict"; Faisal Z Ahmed, Eric D Werker, et al., "Aid and the Rise and Fall of Conflict in the Muslim World," *Quarterly Journal of Political Science* 10, no. 2 (2015): 155–186; Olena Y Nizalova and Irina Murtazashvili, "Exogenous treatment and endogenous factors: Vanishing of omitted variable bias on the interaction term," *Journal of Econometric Methods* 5, no. 1 (2016): 71–77; Maurice JG Bun and Teresa D Harrison, "OLS and IV estimation of regression models including endogenous interaction terms," *Econometric Reviews* 38, no. 7 (2019): 814–827; Ahmed, "Foreign Aid and Repression"; Dreher and Langlotz, "Aid and growth: New evidence using an excludable instrument."

[34] Roubini and Sachs, "Political and economic determinants of budget deficits in the industrial democracies"; Alberto Alesina and Guido Tabellini, "A positive theory of fiscal deficits and government debt," *The review of economic studies* 57, no. 3 (1990): 403–414; Alberto Alesina and Howard Rosenthal, *Partisan politics, divided government, and the economy* (Cambridge University Press, 1995); Scartascini and Crain, *The size and composition of government spending in multi-party systems*.

[35] Round and Odedokun, "Aid effort and its determinants"; Brech and Potrafke, "Donor ideology and types of foreign aid."

interaction between $FRAC_i$ and P_i is explained by the fact that the more frequent aid recipients are "less likely to experience changes in their annual aid receipts" which empirically translates to negative coefficients.[36] Column 1 presents a specification with country-fixed effects and controls. As expected by the theory, the fractionalization of the U.S. House of Representatives remains positively associated (coefficient = 0.237) with aid receipts, as observed in Figure 2. Significantly, the F-statistic (= 25.280) indicates that the instrument is "strong" —given that it exceeds the 9.6 threshold recommended by Stock et al. (2002)— allowing for the interpretation of the second-stage estimates as causal.[37] Columns 2 and 3 demonstrate that the instrument is a powerful predictor of bilateral economic aid even after including period fixed effects and clustering standard errors by country, maintaining a high F-statistic (= 21.920). Fractionalization is excluded from these regressions as it is subsumed by the time-fixed effects. Lastly, in the first-stage regressions, the control variables seem to have their expected effects, given that poorer countries receive more aid (coefficient = −0.864). Having established robust significance for the instrumental variable, we turn to the second stage of the regression.

Table 2 The legislative determinants of US aid (first-stage regression)

	US total aid (log units $2000 US)		
	(1)	(2)	(3)
IV	–0.251***	–0.281***	–0.281***
	-0.034	–0.031	–0.058
Fractionalization	0.237***		
	–0.03		
Initial GDP pc	0.789***	-0.864***	–0.864***
	–0.131	–0.203	–0.245
Assassinations	0.298	0.394 ·	0.394 ·
	–0.242	–0.227	–0.209
Broad Money / GDP (t-1)	0.006	–0.003	–0.003
	–0.004	–0.004	–0.006
Assassinations*Ethnic-Frag	0.075	–0.118	–0.118
	–0.466	–0.435	–0.475
Country effects	Yes	Yes	Yes
Time effects	No	Yes	Yes
Clustered SE	No	No	Yes
Observations	945	945	945
F-Statistic	25.280***	21.920***	21.920***

Note: Estimation via OLS. Robust standard errors, clustered by country reported in parentheses. Significance Levels: '·'p<0.01, '*'p<0.05; '**'p<0.01; '***'p<0.001. Source: The data is taken from the World Bank DataBank, the Cross-National Time Series Data Archive and the Historical Index of Ethnic Fractionalization Dataset.

[36] Ahmed, "Foreign Aid and Repression," 194.

[37] James H Stock, Jonathan H Wright, and Motohiro Yogo, "A survey of weak instruments and weak identification in generalized method of moments," *Journal of Business & Economic Statistics* 20, no. 4 (2002): 518–529.

Table 3 shows the results from the second stage regressions. The results in Panel A are consistent with the increasing consensus that aggregated aid has no significant growth effects, as found by meta-studies on the literature.[38] More specifically, the table reproduces the absence of robust significance found in Dreher and Langlotz (2020) when applying the same instrument and specifications for aggregated aid (Column 1 in Panel A).[39] Likewise, most insignificant results in Columns 2 to 7 align with similar studies that break down aid by purpose, such as Bjørnskov's (2019).[40]

Table 3 The impact of aid on growth (second-stage regression)

	Growth of Gross Domestic Product per capita, 1972-2013						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Panel A: Second stage (Aid lagged t - 1), n = 917							
Total Aid	–0.089						
	(0.217)						
Military Aid		10.150					
		(255.700)					
Democratic Aid			0.055				
			(0.127)				
Health Aid				0.056			
				(0.130)			
Education Aid					0.063		
					(0.145)		
Economic Aid						–0.089	
						(0.213)	
Humanitarian Aid							0.045
							(0.104)
Panel A: Second stage (Aid lagged t - 2), n = 850							
Total Aid	– 0.366 ·						
	(0.204)						
Military Aid		–2.789					
		(5.175)					
Democratic Aid			0.304**				
			(0.113)				
Health Aid				0.284*			
				(0.112)			
Education Aid					0.317**		
					(0.121)		
Economic Aid						–0.361 ·	
						(0.191)	
Humanitarian Aid							0.241**
							(0.093)
Panel C: First stage							
IV	–0.28***	–0.04	0.37***	0.40***	0.37***	0.24***	0.44***
	(0.06)	(0.04)	(0.03)	(0.04)	(0.03)	(0.03)	(0.04)
IV F-statistic	21.92	3.20	96.47	28.01	91.15	43.49	41.03
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes

[38] Doucouliagos and Paldam, "The ineffectiveness of development aid on growth: An update"; Doucouliagos and Paldam, "Aid effectiveness on growth: A meta study."

[39] Dreher and Langlotz, "Aid and growth: New evidence using an excludable instrument."

[40] Bjørnskov, "Types of Foreign Aid."

Note: Estimation via 2SLS. Aid is measured in log units ($2000 US). Controls follow the specifications in Drehrer and Langlotz (2020). Robust standard errors, clustered by country reported in parentheses. Significance Levels: ‘ · ’p<0.1;‘*’p<0.05; ‘**’p<0.01; ‘***’p<0.001. Source: The data is taken from US government’s Foreign Assistance Data, the World Bank DataBank, the Cross-National Time Series Data Archive and the Historical Index of Ethnic Fractionalization Dataset.

Moving to Panel B, we observe contrasting findings regarding the effects of different types of aid on GDP per capita growth after lagging aid for two periods. Firstly, Aggregated aid (Column 1) and Economic aid (Column 6) show negative marginal significance, aligning with previous studies such as Rajan and Subramanian (2008). Yet, they ultimately prove insignificant at conventional levels ($p > 0.05$), consistent with the prevailing literature on aid’s ineffectiveness. Perhaps more intriguingly, the results from other components support the “conditionality” strand of literature, suggesting that aid is most effective when directed toward the underlying basis for growth, particularly those authors emphasizing institutional conditionality.[41] Notably, aid targeted at Democracy, Human Rights, and Governance exhibits highly significant positive growth effects —a unit increase in (logged) democratic aid results in a 0.3% rise in GDP per capita growth, holding all other factors constant— highlighting that political liberalization can act as a conduit for economic growth.[42] This hypothesis is strengthened by the results in section 4.2, which demonstrate the positive effect of Democratic aid on political and civil rights. Moreover, we find similarly positive and conventionally significant effects in human capital accumulation via aid targeted at Health (Column 4) and Education and Social Services (Column 5). These results support the intuitive idea that certain types of aid may require more time to manifest their impact.[43] Furthermore, humanitarian aid also displays a robust positive association, likely reflecting the catch-up component of reconstruction aid, which has been linked to economic growth but is unlikely to reflect long-lasting structural changes.[44] On the other hand, Military aid is not statistically significant and suffers from a weak instrument (F-statistic = 3.20). This is to be expected, given that Congress —and a fortiori its fractionalization— has less influence over the allocation of US military aid.[45]

Ultimately, the results in Table 3 suggest an overall ineffectiveness of aid due to lack of significance or to overly long-time horizons for minimal effects.[46] Yet, these findings are

[41] Jia, “Foreign Aid Conditionality and Economic Growth”; Shaomeng Jia and Claudia R Williamson, “Aid, policies, and growth: why so much confusion?,” *Contemporary Economic Policy* 37, no. 4 (2019): 577–599; Jakob Svensson, “Aid, growth and democracy,” *Economics & politics* 11, no. 3 (1999): 275–297; Peter Boone, *The impact of foreign aid on savings and growth* (London School of Economics / Political Science, Centre for Economic Performance., 1994); Andrew T Young and Kathleen M Sheehan, “Foreign aid, institutional quality, and growth,” *European Journal of Political Economy* 36 (2014): 195–208.

[42] Jonathan Isham, Daniel Kaufmann, and Lant H Pritchett, “Civil liberties, democracy, and the performance of government projects,” *The World Bank Economic Review* 11, no. 2 (1997): 219–242.

[43] Clemens et al., “Counting chickens when they hatch: Timing and the effects of aid on growth.”

[44] Bjørnskov, “Types of Foreign Aid.”

[45] Ahmed, “Does foreign aid harm political rights? Evidence from US aid”; Ahmed, “Foreign Aid and Repression.”

[46]

sufficient to lay the methodological groundwork for policy evaluations that will be used in this paper.[47]

2.2 Normative Results

As established in the "Standard Normative Model" section above, Table 3 leads to the conclusion that U.S. foreign aid *should* flow into Democracy, Human Rights and Governance, Health, Education and Social Services, and Humanitarian Assistance. Moreover, given that we have a higher confidence level in the positive impact of Democratic and Education Aid ($p < 0.01$) which also exhibit the highest expected returns, approximately 0.3% of GDP per capita growth for every log unit increase, more aid should be reallocated to these particular purposes.

The argument can be formalized as follows:

(P1) For any policy *x*, if *x* best promotes positive social outcomes, then *x* must be adopted.

(P2) Social outcomes are determined by the satisfaction of people's preferences.

(C1) Therefore, for any policy *x*, if *x* best promotes the satisfaction of people's preferences, then *x* must be adopted. (from P1-2 and Table 2)

(P3) Income is a good proxy for preference satisfaction. (Assumption)

(C2) Therefore, GDP per capita growth is a good proxy for social welfare (from P2 and P3)

(C3) Therefore, for any policy *x*, if *x* best promotes GDP per capita growth, *x* must be adopted. (from C1 and C2)

(P4) Increasing Democratic and Educational Aid best promotes GDP per capita growth. (Table 3)

(C4) Therefore, Democratic and Educational aid should be increased (from C3 and P4)

The conclusion is fairly intuitive and anything but surprising, given the results. Yet, it is this same reasoning that could have potentially justified the increased level of repression in recipient countries that is associated with higher US aid, as we shall observe in Section 4.1. The value of formalizing the argument above is two-fold. First, given its logical validity, any challenge must focus on the truth of the premises. Whereas rejecting the normative premises (P1) and (P2) amounts to making a moral argument, (P3) and (P4) are empirical premises that require to be challenged on this basis. Second, it introduces the method more fully employed in the next sections.

Returning to Table 1, even if economists hold that *outcomes* rather than processes should be the object of policymaking, ones that are appraised by a *single* method of appraisal rather than multiple and that what matters about outcomes are the consequences for *individuals* rather than groups or the environment, there is an important distinction when it comes to which kinds

[47] A skeptical reader may question the validity of the results since most of the purpose-disaggregation happens in the first two decades of this century, and the observations only go until 2013. However, as a robustness check, we exclude the interaction term between *assassinations* and ethnolinguistic *fractionalization*, which is the reason for the 2013 limit. We find that the results do not depend on this choice. These findings are reported in the appendix Table A2

of outcomes for individuals matter. Following Haussman's description in Table 1, we can categorize these into four — (1) Welfare, (2) Freedom, (3) Rights, and (4) Justice — and if we additionally introduce an empirical premise identifying the best measurement for what determines each of these outcomes then we can deduce a set of *normative* policy recommendations as we will explore below.

3 Data and Extended Welfare Model

3.1 Extended Normative Model

There is an extensive literature exploring alternative outcome variables to assess foreign aid effectiveness beyond the conventional focus on economic growth. Some studies have used poverty as the optimal metric,[48] while others have looked at inequality, usually through the GINI coefficient.[49] Some researchers have advocated for Human Development as the proper gauge for evaluating aid's impact.[50] However, the novelty of the methodology employed in this paper lies in its quest to avoid arbitrariness by appealing to a comprehensive set of values that justifies aid policy in all contexts.

Though Haussman et al. (2019) introduces three additional evaluative measures alongside Welfare for economic policy, namely Freedom, Rights, and Justice, we will primarily focus on the first two: Freedom and Rights. To this point, it is crucial to distinguish between the two main interpretations of freedom. The concept of *positive* freedom refers to an individual's capacity and opportunities to act according to their own plans. In contrast, *negative* freedom pertains to the absence of constraints and barriers in decision-making. This essential distinction allows us to simplify the number of measures used. For instance, Rights can be effectively represented by the POLITICAL RIGHTS and CIVIL LIBERTIES indices from Freedom House, both aligning with the concept of *negative* freedom. On the other hand, Human Development, as quantified by the Human Development Index (HDI), serves as a representation of Welfare but also of *positive* freedom. The former reflects what was identified as "objective" goods in Table 1, the latter reflects Amartya Sen's capabilities approach. This new perspective on gauging aid's effectiveness provides a better framework by which we choose outcome variables.

Table 4 Alternative Social Outcomes

[48] Paul Mosley, John Hudson, and Arjan Verschoor, "Aid, poverty reduction and the 'new conditionality'," *The economic journal* 114, no. 496 (2004): F217–F243; Denis Cogneau and Jean-David Naudet, "Who deserves aid? Equality of opportunity, international aid, and poverty reduction," *World Development* 35, no. 1 (2007): 104–120; John Page and Abebe Shimeles, "Aid, employment and poverty reduction in Africa," *African Development Review* 27, no. S1 (2015): 17–30; Ryan C Briggs, "Does foreign aid target the poorest?," *International Organization* 71, no. 1 (2017): 187–206.

[49] Alberto Chong, Mark Gradstein, and Cecilia Calderon, "Can foreign aid reduce income inequality and poverty?," *Public choice* 140 (2009): 59–84.

[50] Kevin Watkins, *International cooperation at a crossroads: Aid, trade and security in an unequal world* (Human Development Report, 2005); Claudia R Williamson, "Foreign aid and human development: The impact of foreign aid to the health sector," *Southern Economic Journal* 75, no. 1 (2008): 188–207; Robert Gillanders, *The effects of foreign aid in Sub-Saharan Africa*, technical report 3, Autumn (2016), 339–360; Asongu and Nwachukwu, "Foreign aid and inclusive development: Updated evidence from Africa, 2005–2012."

(A) Which outcomes matters?			(B) What is it determined by?	(C) What is its best approximation?
Welfare	*Freedom*	*Rights*		
Yes	No	No	Preference-satisfaction	GDP per capita
Yes	Yes (Positive)	No	Capabilities	Human Development Index
No	Yes (Negative)	Yes	Civil and Political Rights	Freedom House's indices

3.2 Extended Empirical Model

Having defined the measures to evaluate alternative positive outcomes in recipient countries, we will now consider the additional two-stage systems.

Firstly, to assess the Human Development Index (HDI), which serves as a measure for both welfare and positive freedom, we will employ the first-stage regression (I) as introduced in Section 1, and by the following second-stage regression:

$$\hat{Aid}_{i,t} = \alpha_1\left(FRAC_t \times P_i\right) + \alpha_2 X_{i,t} + \eta_i + \tau_t + u_{i,t} \quad \text{(I)}$$

$$GrowthHDI_{i,t} = \gamma_1 \hat{Aid}_{i,t-1} + \gamma_2 X_{i,t} + \eta_i + \tau_t + \epsilon_{2,i,t} \quad \text{(III)}$$

In this regression, $GrowthHDI_{i,t}$ represents the recipient country i's average annual HDI growth over a four-year period t, akin to the measurement used for $GrowthGDP_{i,t}$ in the original model. Data to construct the HDI Growth variable is sourced from the United Nations Development Program's Human Development Report (2022). The vector of controls $\mathbf{X_{i,t}}$ and the logarithmic measure of $\hat{Aid}_{i,t-1}$, instrumented by the variable ($FRAC_t \times P_i$), remain unchanged from the original $GrowthGDP_{i,t}$ model. Moreover, η_i and τ_t represent country and period fixed effects, respectively. For the regression of Political Rights and Civil Liberties, however, we must substantially alter the model:

$$\hat{Aid}_{i,t} = \delta_1\left(FRAC_t \times P_i\right) + \delta_2 Y_{i,t} + \eta_i + \tau_t + u_{2i,t} \quad \text{(IV)}$$

$$RIGHTS_{i,t} = \lambda_1 \hat{Aid}_{i,t-1} + \lambda_2 Y_{i,t} + \eta_i + \tau_t + \epsilon_{3,i,t} \quad \text{(V)}$$

$$LIBERTIES_{i,t} = \mu_1 \hat{Aid}_{i,t-1} + \mu_2 Y_{i,t} + \eta_i + \tau_t + \epsilon_{4,i,t} \quad \text{(VI)}$$

Here, $RIGHTS_{i,t}$ and $LIBERTIES_{i,t}$ represet Freedom House's POLITICAL RIGHTS index and CIVIL LIBERTIES index, respectively. The POLITICAL RIGHTS index assesses the level of political rights within a country which refers to people's ability to participate freely in the political process. This index evaluates electoral processes, political pluralism, participation, and the government function for each country. On the other hand, the CIVIL LIBERTIES index gauges freedom and protection from the state apparatus, examining freedom of expression and belief, associational and organizational rights, the rule of law, personal autonomy, and individual rights. Both indices range on a seven-point (1–7) scale, where higher values of POLITICAL RIGHTS and CIVIL LIBERTIES (e.g., 6 or 7) indicate less freedom.

Controls. I follow the specifications from Ahmed (2016),[51] who controls for *(logged) GDP per Capita*, *GDP per capita growth*, and population size via *(logged) population*, all sourced from the World Bank's DataBank (2021). Moreover, to account for aid allocation's geopolitical motives, we control for U.N. Security Council (UNSC) membership with a dummy variable and for the consumption of U.S. exports, measured as *(logged) U.S. exports* which controls for U.S. business interests. Information about UNSC membership is publicly available from the United Nations, and U.S. Exports data is obtained from the International Monetary Fund. Significantly, this specification allows for a larger sample size, extending observations from 1985 until 2021 (for a total of 9 periods) across more than 150 countries. We will begin by looking at the latter model's first-stage regression.

4 Extended Model Results

4.1 Empirical Results

Table 5 The determinants of US aid with Ahmed (2016) specifications (first-stage regression)

	Type of U.S. aid (log units $2000 U.S.)						
	Total	*Military*	*Dem.*	*Health*	*Educ.*	*Econ.*	*Human*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
IV	–0.15***	0.02	0.14***	0.30***	0.29***	-0.19***	0.31***
	(0.04)	(0.04)	(0.03)	(0.05)	(0.04)	(0.04)	(0.05)
Log GDP pc	−0.53*	0.70 ·	0.42	0.78*	0.92*	−0.43	−1.60***
	(0.25)	(0.40)	(0.30)	(0.37)	(0.36)	(0.42)	(0.35)
GDP pc Growth	−0.01	0.04 ·	0.08***	0.13***	0.11***	−0.04 ·	0.02
	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.03)
Log population	2.34***	2.32**	4.18***	5.16***	2.66*	2.55***	1.33
	(0.64)	(0.78)	(0.98)	(1.22)	(1.12)	(0.76)	(0.96)
UNSC member	−0.14	−0.03	0.28	−0.23	0.22	−0.24	0.03
	(0.17)	(0.18)	(0.16)	(0.25)	(0.20)	(0.22)	(0.22)
Log US Exports	0.48	0.30	−1.53**	–1.24*	−0.08	1.55***	0.13
	(0.37)	(0.39)	(0.51)	(0.61)	(0.59)	(0.43)	(0.54)
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Clustered SE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,390	1,390	1,390	1,390	1,390	1,390	1,390
F Statistic	13.75	7.24	25.69	31.47	19.11	12.83	14.90

Note: Estimation via OLS. Robust standard errors, clustered by country reported in parentheses. Significance Levels: ' · 'p<0.1;'*'p<0.05; '**'p<0.01; '***'p<0.001

Table 5, displaying the results of the first-stage regression model (IV), demonstrates that the instrumental variable ($FRAC_t \times P_i$) remains a robust determinant for most types of U.S. aid,

[51] Ahmed, "Does foreign aid harm political rights? Evidence from US aid."

even after employing Ahmed's specifications of controls.[52] In Column 1, we observe that the instrument is valid with a strong F-statistic (= 13.75) for total aid receipts, aligning with previous literature.[53] For all types of aid, except for military aid targeting *Peace and Security* (Column 2) —which is less influenced by Congress— the F-statistics exceed the 9.6. threshold, consistent with the findings in Table 2.

The control variables generally exhibit the expected effects. Poorer countries tend to receive more aggregated aid (Column 1), through the contrasting positive results of Health and Education aid receipts warrant further investigation. Additionally, countries experiencing growth tend to be 'rewarded' with more aid (Columns 3, 4, and 5). Population size is positively associated with the amount of aid in nearly every column. However, it is crucial to recognize that smaller countries are also expected to receive *disproportionally* more aid per capita.[54] We also observe the well-documented positive relationship between U.S. aid and Exports (Column 6),[55] where a percentage increase in U.S. exports to a recipient country results in a 1.55% rise in economic aid, holding all other factors constant. More intriguingly, however, we also see a significant and negative association ($p<0.01$) that emerges between U.S. Exports and aid targeted at Democracy, Human Rights, and Governance (Column 3). Though this finding warrants further analysis, it may reflect the prioritization of economic policy over democratization in U.S. foreign policy. With the instrument's validity established for most aid categories, we can now proceed to the second-stage regressions of the extended model.

Table 6 The impact of aid on alternative outcomes

Social Outcomes	*Welfare*	*Rights*	
	(Positive Freedom)	*(Negative Freedom)*	
	HDI Growth	Political Rights	Civil Liberties
	(1)	(2)	(3)
Total Aid	−0.145	0.106**	0.119***
	(0.089)	(0.037)	(0.031)
Military Aid	23.780	0.493	0.553
	(882.700)	(0.354)	(0.378)
Democratic Aid	0.117*	−0.125**	−0.140***
	(0.060)	(0.044)	(0.036)
Health Aid	0.072·	−0.084**	−0.094***
	(0.037)	(0.028)	(0.022)
Education Aid	0.087*	−0.091**	−0.102***
	(0.043)	(0.031)	(0.024)
Economic Aid	−0.150·	0.087**	0.097***
	(0.079)	(0.030)	(0.024)

[52] Ahmed.
[53] Ahmed, "Does foreign aid harm political rights? Evidence from US aid"; Ahmed, "Foreign Aid and Repression."
[54] Alberto Alesina and David Dollar, "Who gives foreign aid to whom and why?," *Journal of economic growth* 5 (2000): 33–63.
[55] Robert K Fleck and Christopher Kilby, "How do political changes influence US bilateral aid allocations? Evidence from panel data," *Review of Development Economics* 10, no. 2 (2006): 210–223.

Humanitarian Aid	0.068*	−0.068**	−0.076***
	0.034	(0.023)	(0.018)
Lagged Aid (t-1)	Yes	Yes	Yes
Drehrer (2020) controls	Yes	No	No
Ahmed (2016) controls	No	Yes	Yes
Fixed effects	Yes	Yes	Yes
Observations	646	1,350	1,350

Note: Estimation via 2SLS. A different instrumental variable regression was conducted for every result. Robust standard errors, clustered by country reported in parentheses. Significance levels: ' ' p<0.1;'*' p<0.05; '**' p<0.01; '***' p<0.001

The results presented in Table 6 provide better insight into the multifaceted consequences of foreign aid. In Column 1, we observe that a unit increase in (logged) aid targeting Democracy, Human Rights, and Governance leads to a 0.117% growth in the Human Development Index (HDI) significant at conventional levels ($p < 0.05$). Similarly, Education aid positively affects HDI growth to an equally statistically significant extent, where a unit increase in (logged) U.S. aid targeting Education and Social Services corresponds to a 0.087% increase in HDI growth. Moreover, we also find a positive impact from health aid, albeit only marginally significant ($p < 0.1$), in contrast to the absence of results in Williamson (2008) and in support of the results in Asongu and Nwachukwu (2017).[56] Given that HDI measures life expectancy, education, and income, it is expected that aid directed at health, education, and economic growth would yield a positive effect, and although the seemingly negative effect of economic aid may initially contradict this hypothesis, it aligns with the lack of significant results at conventional levels from the first 2SLS model (I) in Section 1.2. These results suggest that economic aid does not foster positive changes in income measures, reinforcing the findings in Table 3. Moreover, though the positive effects on Human Development of aid directed at social infrastructure are consistent with Asongu and Nwachukwu,[57] the positive effect (coefficient = 0.068) of Humanitarian assistance contrasts with their own negative results. This difference may be explained by the fact that Asongu and Nwachukwu adjust the Human Development Index for inequality (IDHI), which may eliminate the positive effect on Human Development caused by the rises in income from Humanitarian assistance.[58]

Moving on to Columns 2 and 3, we note a substantial increase in significance levels ($p < 0.01$ for Political Rights and $p < 0.001$ for Civil Liberties). Additionally, the effects of foreign aid on both dependent variables exhibit similar coefficients and signs. Remembering that higher ratings in the POLITICAL RIGHTS index and CIVIL LIBERTIES index represent lower political rights and civil liberties, the results indicate a concerning positive association between U.S. aid and repression in recipient countries. The effect is highly significant for both Political Rights ($p < 0.01$) and Civil Liberties ($p < 0.001$), indicating that U.S. aid is inadvertently supporting the curtailment of political freedom and human rights. Disaggregating foreign aid into its components reveals that the deterioration in both measures is primarily driven by aid targeted at economic development. And although Military Aid likely

[56] Williamson, "Foreign aid and human development: The impact of foreign aid to the health sector"; Asongu and Nwachukwu, "Foreign aid and inclusive development: Updated evidence from Africa, 2005– 2012."
[57] Asongu and Nwachukwu, "Foreign aid and inclusive development: Updated evidence from Africa,
[58] Bjørnskov, "Types of Foreign Aid."

also plays a significant role, the instrument's weakness precludes a comprehensive evaluation of this relationship. These findings align with previous research by Ahmed (2019, 2016) and raise questions about the impact of aid on recipient countries' political landscapes.[59]

Moreover, while Ahmed's analysis finds that a unit increase in log aid raises the POLITICAL RIGHTS index by 0.171, our results suggest a similar yet lower increase of 0.106 points (Column 2). This contrast implies that since 2008 (the latest observations in Ahmed's analysis), the relationship between U.S. aid and political freedom improved over the next decade. Furthermore, going beyond economic and military aid —Ahmed's sole focus— provides more reassuring results. The rest of the aid components, apart from economic aid, exhibit a significant negative association with repression. As would be expected, these results demonstrate that aid targeted at fostering Democracy, Human Rights, and Governance exerts the most substantial effect in mitigating repressive practices, where a unit increase in log democratic aid corresponds to a substantial decline of 0.125 points in the POLITICAL RIGHTS index and 0.140 in the CIVIL LIBERTIES index.

These findings above align with the notion that aid directed toward social and institutional aspects can yield positive long-term effects and continue to support the strand in the literature conditioning economic growth on institutional quality. However, it is crucial to note that the positive effects are relatively modest, with aid contributing only small percentage increases to HDI growth, Political Rights, and Civil Liberties.

4.2 Normative Results

The original formalization from section 1.1, can be reproduced into the following structure, using the classification used in Table 4: Here, 'A' refers to a given social outcome, say Welfare, 'B' to a particular interpretation, such as preference satisfaction, and 'C' to its measurement, GDP growth for example.

> (P1) For any policy *x*, if *x* promotes/hinders positive social outcome A, then *x* must be adopted/avoided. (Normative Premise)
>
> (P2) Social outcome A should be interpreted as B. (Normative Premise)
>
> (C1) **Therefore, for any policy *x*, if *x* promotes/hinders B, then *x* must be adopted/avoided. (from P1 and P2)**
>
> (P3) B is best approximated by measure C. (Empirical Premise)
>
> (C2) **Therefore, for any policy *x*, if *x* causes C to increase/decrease, *x* must be adopted/avoided. (from C1 and P3)**

The comprehensive analysis of the 2SLS model, combined with the findings in Tables 3 and 6, allows us to derive concrete *normative* policy recommendations concerning U.S. foreign aid allocation.

Welfare: Preference-satisfaction. Assuming the main goal of policy is to promote (A) welfare, interpreted as (B) the satisfaction of people's preferences, and is best measured by (C)

[59] Ahmed, "Foreign Aid and Repression"; Ahmed, "Does foreign aid harm political rights? Evidence from US aid."

GDP per capita growth, the U.S. should prioritize allocating aid towards 'Democracy, Human Rights and Governance,' and 'Education and Social Services' to optimize aid's impact. These two categories of aid exhibit the most substantial positive effects on economic growth and are highly statistically significant, bolstering our confidence in the results. Moreover, reallocating aid away from Economic aid seems equally necessary: either because Economic Aid has a negative impact (though only marginally significant) on the long-term economic growth of recipient countries; or because Economic aid has no robustly significant effects and the U.S. should use these resources to promote the GDP per capita growth of its own citizens (or of other countries' via alternative aid categories).

Welfare and Freedom: Human Development. A similar set of policy recommendations holds true when we consider (A) welfare as (B) a set "Objective" goods (or as Capabilities) as the key policy metric, measured by (C) HDI growth. In this context, the U.S. should also support aid allocation towards 'Democracy, Human Rights and Governance,' and 'Education and Social Services,' as they have the most substantial positive effects on HDI growth. Furthermore, Economic aid should also be scaled back, given its insignificant or negative impact on HDI growth, allowing resources to be channeled more efficiently.

Rights: Political Freedom and Civil Liberties. Lastly, when our focus is on (A) Rights, interpreted as (B) political freedom or human rights, and measured through (C) the FreedomHouse's indices, the evidence once more points towards the importance of prioritizing aid to 'Democracy, Human Rights and Governance' and 'Education and Social Services'. These categories exhibit the most significant positive effects on recipient countries' political freedom and human rights. Conversely, Economic aid should be eliminated, as it shows a highly significant and positive association with repression. By reallocating aid from Economic aid to Democracy and Education, the U.S. can align its aid allocation with its commitment to promote human rights, political freedom and institutional quality in in recipient nations.

In conclusion, regardless of the specific social outcomes we prioritize, our results consistently recommend reallocating aid away from Economic aid and towards 'Democracy, Human Rights and Governance,' and 'Education and Social Services.' These categories of foreign aid demonstrate the most promise in fostering economic growth, human development, and the protection of political freedom and human rights. By tailoring aid allocation to these areas, the U.S. can play a more positive role in shaping the development trajectory of recipient countries.

5 Conclusion

While previous studies have introduced various measures to assess aid's impact,[60] examined disaggregated aid categories,[61] and used legislative fragmentation as an instrumental variable,[62] this study stands out by combining these three elements, presenting a novel analysis.

By employing the fractionalization of the House of Representatives as an instrumental variable, this paper demonstrates the need to reallocate Economic Aid towards aid targeting democracy and education to maximize the positive impact of U.S. foreign aid. Moreover, the repressive consequences associated with Economic Aid raise concerns, urging policymakers to scrutinize and potentially reduce this kind of assistance. With that said, while this paper makes significant strides in understanding the multifaceted dynamics of aid, further studies must delve into the intricacies of aid delivery mechanisms and find other ways of exploring the relationship between U.S. Military Aid, welfare and rights. Although our instrumental variable served its purpose well, evaluating the impact of Military Aid requires alternative methodologies.

What is most significant, however, is that these policy recommendations are not driven by evaluating pre-existent American strategic interests or geopolitical motives. Which, as discussed in the section "Legitimate Well-Being Policy," would amount to *positive* policy recommendations, i.e., judgments of the form:

(1) *If* the U.S. foreign policy strategy aims to create potential markets for U.S. exports by increasing the development of emerging economies, *then* the U.S. should reallocate Economic aid towards Democratic and Education aid.

Instead, they are rooted in the overlapping consensus of contrasting evaluative frameworks. Leading to the following *normative* policy recommendation.

(2) The U.S. *should* reallocate its Economic aid towards aid targeting Democracy, Human Rights and Governance, and Education and Social Services.

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[60] Mosley, Hudson, and Verschoor, "Aid, poverty reduction and the 'new conditionality'"; Cogneau and Naudet, "Who deserves aid? Equality of opportunity, international aid, and poverty reduction"; Page and Shimeles, "Aid, employment and poverty reduction in Africa"; Briggs, "Does foreign aid target the poorest?"; Chong, Gradstein, and Calderon, "Can foreign aid reduce income inequality and poverty?"; Watkins, *International cooperation at a crossroads: Aid, trade and security in an unequal world*; Williamson, "Foreign aid and human development: The impact of foreign aid to the health sector"; Gillanders, *The effects of foreign aid in Sub-Saharan Africa*; Asongu and Nwachukwu, "Foreign aid and inclusive development: Updated evidence from Africa, 2005–2012."

[61] Bjørnskov, "Types of Foreign Aid"; Asongu and Nwachukwu, "Foreign aid and inclusive development: Updated evidence from Africa, 2005–2012"; Clemens et al., "Counting chickens when they hatch: Timing and the effects of aid on growth"; Rajan and Subramanian, "Aid and growth: What does the cross-country evidence really show?"; Williamson, "Foreign aid and human development: The impact of foreign aid to the health sector"; Philip Michael Kargbo and Kunal Sen, "Aid categories that foster pro-poor growth: The case of Sierra Leone," *African Development Review* 26, no. 2 (2014): 416–429.

[62] Dreher and Langlotz, "Aid and growth: New evidence using an excludable instrument"; Dreher, Fuchs, and Langlotz, "The effects of foreign aid on refugee flows"; Ahmed, "Foreign Aid and Repression"; Ahmed, "Does foreign aid harm political rights? Evidence from US aid"; Nunn and Qian, "US food aid and civil conflict."

This recommendation is appropriate because it is valid from multiple moral standpoints, ensuring a greater level of neutrality, and thus objectivity, while also addressing some of the paternalistic concerns associated with foreign aid policy. This ultimately provides a more legitimate framework that, on the one hand, shows how aid is, in fact, effective; and, on the other hand, clearly articulates why aid inflows to autocratic regimes can almost never be.

However, there are three significant limitations to this approach's generalizability. Firstly, further argumentation is required to demonstrate why the moral rubric used to evaluate domestic policies also applies to foreign aid. While it seems clear that ethical considerations should be applied equally to all people, regardless of residence, the difference in how each type of policy gains legitimacy needs to be taken into account. Secondly, a significant issue that failed to be addressed pertains to the negative consequences of foreign aid policy on the tax-paying citizens of the donating country, in this case, the U.S. Lastly, regression analysis makes it necessary to focus policy's appraisal only to *outcomes* rather than *processes*. Thus, it is unable to account for other normative frameworks such as Robert Nozick's[63] rights as side constraints. Unfortunately, each of these concerns requires an extensive and in-depth normative discussion that goes beyond this paper's scope and shall thus be left for another time.

In conclusion, it is crucial to recognize both the significant evaluative commitments that underlie policy recommendations and that these cannot be avoided. Making these commitments explicit and enhancing the transparency of our evaluative framework can lead to more informed and effective policymaking, both, domestically and internationally, enabling policymakers to develop aid strategies that drive positive social change in recipient nations. While Economics has often tried to be a purely positive discipline, this cannot be sustained, especially in development and welfare economics, where trade-offs may consist of highly normative matters such as forswearing civil liberties and political freedoms to satisfy citizens' preferences. The journey to enhance policy in general, and the effectiveness of foreign aid in particular, should encompass not only empirical analysis but also a clear understanding of our underlying evaluative judgments. Only by integrating both aspects can we contribute to advancing policies that foster meaningful development at home and abroad.

[63] Robert Nozick, *Anarchy, State, and Utopia* (John Wiley & Sons, 1974).

Appendix A

Table A1 Summary Statistics

	Obs.	Mean	St. Dev.	Min	Max
Panel A: Variables Table 2,3,5					
Log Total U.S. aid	2,821	7.62	5.07	0.00	17.03
Log U.S. Military aid	2,821	5.14	4.53	0.00	16.72
Log U.S. Democratic aid	2,821	3.17	4.11	0.00	15.27
Log U.S. Health aid	2,821	2.45	4.19	0.00	14.48
Log U.S. Education aid	2,821	2.16	3.83	0.00	13.28
Log U.S. Economic aid	2,821	5.79	5.08	0.00	16.98
Log U.S. Humanitarian aid	2,821	3.08	4.39	0.00	14.64
Fractionalization	2,821	86.24	8.04	67.47	96.90
Probability of receiving aid	2,821	0.71	0.30	0.04	1.00
Panel B: Variables Table 2,3					
GDP per capita Growth	1,939	1.68	4.10	−21.02	60.16
Log initial GDP pc	1,951	7.88	1.63	3.44	11.70
Assassinations	2,093	0.17	0.68	0.00	9.25
Ethno-linguistic fragmentation	1,439	0.45	0.26	0.005	0.89
Broad Money / GDP	1,589	49.25	45.05	6.33	642.70
Panel C: Variables Table 5, 6					
HDI Growth	1,327	0.66	0.92	−6.06	4.97
Political Rights index	2,181	3.75	2.16	1.00	7.00
Civil Liberties index	2,181	3.70	1.87	1.00	7.00
Log GDP per capita	2,003	7.94	1.61	4.41	11.74
Log population	2,297	15.12	2.18	8.71	21.06
UNSC membership	2,821	0.11	0.31	0	1
Log U.S. Exports	1,637	0.56	0.86	0.00	5.04

Table A2 The impact of aid on growth excluding etho-linguistic fragmentation

	Growth of GDP per capita, 1972-2021, 2SLS						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Panel A: Second stage (Aid lagged t-1), n = 1,358							
Total Aid	−0.180						
	(0.15)						
Military Aid		−1.746					
		(3.63)					
Democratic Aid			0.135				
			(0.102)				
Health Aid				0.129			
				(0.100)			
Education Aid					0.147		
					(0.112)		
Economic Aid						−0.178	
						(0.147)	
Humanitarian Aid							0.114
							(0.088)
Panel B: First stage							
IV	−0.28***	−0.03	0.37***	0.42***	0.38***	−0.28***	0.44***
	(0.06)	(0.05)	(0.03)	(0.04)	(0.03)	(0.04)	(0.04)
IV F-statistic	41.32	3.98	53.87	47.79	45.48	20.62	66.81
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DL Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: Estimation via 2SLS. Aid is measured in log units ($2000 US). Controls follow the specifications in Dreher and Langlotz (2020) except for the interaction between assassinations and ethno-linguistic fractionalization. Their measure for M2/GDP is replaced by Broad Money/GDP. Robust standard errors, clustered by country reported in parentheses. Significance Levels: '·'p<0.1;'*'p<0.05; '**'p<0.01; '***'p<0.001. Source: The data is taken from US government's Foreign Assistance Data, the World Bank DataBank and the Cross-National Time Series Data Archive

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