



**Theoretical Criticisms and Policy Optimism:
Assessing the Debates on Foreign Aid**

Alice Sindzingre



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Theoretical Criticisms and Policy Optimism: Assessing the Debates on Foreign Aid

Alice N. Sindzingre

Abstract

Developing countries are the recipients of important flows of foreign aid. Since the 2000s, the efficiency of such flows is a matter of heated debates. Indeed, aid flows are directed to some developing countries sometimes for decades, e.g. since the post-independence era in the 1960s for many Sub-Saharan African countries. The results, however, may be viewed as disappointing, since these countries remain at low levels of development in many dimensions, not only in terms of per capita income but also of human development. In this context, the emergence of new players, such as private donors or emerging countries, in particular China, introduces additional complexity in the debates. The paper critically analyses the main features of foreign aid at the beginning of the 21st century. It discusses the key facts as well as the most important theoretical debates. It shows that the 2000s have witnessed a marked emphasis on the detrimental effects of aid and that studies of the impact of aid are therefore characterised by uncertainty and inherent tensions: indeed, this emphasis coexist with a paradigm in the policy-making sphere that relies on the benefits of aid and the necessity of increasing aid as a condition for poor countries to get out of their situation. The paper firstly defines the concept of 'aid', and shows its complexity, as there are many different sources and types of aid flows. Secondly, it presents an overview of the key facts regarding global aid flows. Thirdly, it examines a much-debated key theoretical justification of aid, i.e. the impact of aid on the growth of recipient countries. Fourthly, it assesses the increasing controversies regarding aid, which underscore its negative effects at the macroeconomic level, in particular the problems created by aid dependence. It finally underlines the other negative effects of aid, which stem from the characteristics of the aid relationship itself, notably the problems of incentives, political economy and coordination.

Keywords: aid flows, China, development, dependence, economic growth, foreign aid, policy making, political economy, private donors

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1. Introduction

Developing countries are characterised by the fact that they are the recipients of important flows of Official Development Assistance (ODA), or foreign aid. Since the beginning of the 2000s, the efficiency of such flows has been a matter of extremely heated debate: indeed, aid flows have been directed towards some developing countries for decades, e.g. since the post-independence era in the 1960s for many Sub-Saharan African countries.

The results, however, may be considered as disappointing, since these countries remain at low levels of development in many dimensions, not only that of per capita income but also the dimensions of human development – education and health. In this context, the emergence of new players, such as private donors or emerging countries, in particular China, introduces additional complexity in the debates.

The paper critically analyses the main features of foreign aid at the beginning of the 21st century. It discusses the key facts as well as the most important theoretical debates. It shows that the 2000s witness a marked emphasis on the detrimental effects of aid and that studies of the impact of aid are therefore characterised by uncertainty and inherent tensions: indeed, this emphasis on the negative consequences of aid coexist with a paradigm that has been preeminent in the international policy-making sphere since the 2000s, which relies on the claiming of the benefits of aid and the necessity of increasing aid as a condition for poor countries to get out of their situation – key milestones of this paradigm having been, among others, the United Nations Millennium Development Goals and the associated donor's commitments, or the 2005 G8 Gleneagles Summit and its promises of aid ‘surges’.

The paper is organised as follows. It firstly defines the concept of ‘aid’, and shows that it is a very complex task, as there are many different sources and types of aid flows: this diversity is important to highlight, as it underscores the fragility of the conclusions of a great number of studies that only rely on econometric models that only rely on the variable of ‘aid’ in general – although they address crucial issues, such as, for example, the impacts or the effectiveness of ‘aid’. Secondly, it presents an overview of the key facts regarding global aid flows. Thirdly, it examines a much-debated central theoretical justification of aid, i.e. the impact of aid on the growth of recipient countries. Fourthly, it assesses the increasing controversies regarding aid, which underscore its negative effects at the macroeconomic level, in particular the problems created by aid dependence. It finally underscores the other negative effects of aid, which stem from the characteristics of the aid relationship itself, notably the political economy of the aid relationship per se, the problems of the divergence of donors’ and recipients’ incentives, and those of donor coordination and aid fragmentation.

2. Defining ‘aid’, a necessary but complex task

In order to rigorously assess the many dimensions and impacts of aid, including that of new players such as China, it is necessary to define the concept. This section underscores the importance and complexity of definitions (Official Development Assistance and other types of flows), the variety of sources of aid and the different terms and conditions of aid (tied aid, concessional vs. non-concessional loans, for example). The main source on this issue is the OECD Development Assistance Committee (DAC) and its annual reports (Development Cooperation Reports)¹. Such a complexity regarding what is coined as ‘aid’ and the diversity of the types of aid is a crucial fact. It warns about the possible weakness of results from econometric modelling that rely on broad variables such as ‘aid’ and of the conclusions drawn from them: assessments of impacts and effectiveness of aid require careful and precise definitions of the concepts and flows considered.

Firstly, it is important to recall that there are various sources of aid: aid may be provided by multilateral agencies – e.g. the international financial institutions (IFIs, the IMF and the World Bank) or regional institutions, such as the European Union (EU), which is very active in Sub-Saharan Africa (SSA), the African Development Bank, the Asian Development Bank, and many others –, and by bilateral sources. A substantial part of aid to a region such as Africa, which is characterised by a great number of low-income and aid dependent countries, is thus channelled through multilateral agencies.

The main donors are members of the OECD’s Development Assistance Committee (DAC), which include 24 members (most European states, Japan, the US, Australia, New Zealand, Switzerland...). The World Bank, IMF and UNDP participate as observers. Depending on their domestic and foreign policy as well as their international geopolitical weight, some countries prefer to use the multilateral channel – i.e. the World Bank, the European Commission, the United Nations or regional banks, such as the African Development Bank or the Asian Development Bank, while other countries prefer to use the bilateral channel.

2.1. Definitions matter

Aid, or Official Development Assistance (ODA), is an element of global development finance. Global development finance can be private (e.g., remittances, foreign direct investment, portfolio equity, private debt and private grants) or official.

Official development finance includes: 1) Official Development Assistance (ODA) (i.e. grants and concessional loans); 2) Other Official Flows (OOF), i.e. export credits (concessional or market-rate) and other OOF (Bräutigam 2010: 9). ODA has thus to be distinguished from the ‘Other Official Flows’,

¹ The DAC works with the OECD Development Cooperation Directorate: see the DCD-DAC website: http://www.oecd.org/department/0,2688,en_2649_33721_1_1_1_1,00.html. The AidData project is also a key source regarding global aid flows and projects: <http://www.aiddata.org/home/index>.

bilateral and multilateral, as well as from ‘Private Flows’ – i.e., direct investment, international bank lending, bond lending, other private, private export credits, securities of multilateral agencies, bilateral portfolio investment.

According to the annual OECD DAC Development Cooperation Report (OECD 2010), official financial flows refer to the net disbursements by official sources to a recipient country. A disbursement is defined as “the release of funds to – or the purchase of goods or services for – a recipient; by extension, the amount thus spent. Disbursements record the actual international transfer of financial resources, or of goods or services valued at the cost to the donor. [...] They may be recorded gross (the total amount disbursed over a given accounting period) or net (the gross amount less any repayments of loan principal or recoveries on grants received during the same period)”.²

They must be distinguished from ODA (Official Development Assistance). For the DAC, the words ‘aid’ and ‘assistance’ refer only to flows which qualify as ODA. The DAC provides a definition of ODA that is fairly technical, which is worth quoting: “grants or loans to countries and territories on the DAC list of ODA recipients and multilateral agencies that are undertaken by the official sector at concessional terms (i.e. with a grant element of at least 25%) and that have the promotion of the economic development and welfare of developing countries as their main objective. In addition to financial flows, technical co-operation is included in aid. Grants, loans and credits for military purposes are excluded”.

It is often thought that aid is meant to help and provide assistance to the needy, that it is driven by altruistic, charitable and humanitarian motives, and that for these reasons it is mostly made of gifts, which would logical. In fact, ODA includes grants, defined by the DAC as “transfers made in cash, goods or services for which no repayment is required”, but also some proportion of loans. Loans are defined as “transfers for which repayment is required”.

This implies that aid recipient countries must reimburse some part of this assistance, even if the loan share of total ODA is low for most bilateral donors – but higher for multilateral and regional agencies –, and even if these loans must be concessional, i.e. including with a ‘grant element’ of at least 25%.

Table 1: Other terms parameters, for loan-giving DAC members, 2008

	Australia	Belgium	France	Germany	Italy	Japan	Portugal	Spain	Total DAC
Loan share of total ODA (%)	0,1	1,6	20,7	12,2	6,2	49,6	22,7	19,9	11,2

Source: OECD 2010: 224.

² All definitions can be found in the ‘Glossary’ included in the DAC annual reports:

http://www.oecd.org/document/24/0,3746,en_2649_34447_48745304_1_1_1_1,00.html.

See also: http://www.oecd.org/document/32/0,3343,en_2649_33721_42632800_1_1_1_1,00.html.

Aid is indeed defined by the proportion of the ‘grant element’ that the financial flow includes. The notion of ‘grant element’ is very technical. It is worth quoting the DAC definition in order to highlight the difficulty of defining aid and underscore that the DAC definition of aid – and that of international aid statistics – encompasses grants, i.e. what the general public would consider as aid, and concessional loans. A grant element “reflects the financial terms of a commitment: interest rate, maturity and grace period (interval to first repayment of capital). It measures the concessionality of a loan, expressed as the percentage by which the present value of the expected stream of repayments falls short of the repayments that would have been generated at a given reference rate of interest. The reference rate is 10% in DAC statistics. This rate was selected as a proxy for the marginal efficiency of domestic investment, i.e. as an indication of the opportunity cost to the donor of making the funds available. Thus, the grant element is nil for a loan carrying an interest rate of 10%; it is 100% for a grant; and it lies between these two limits for a loan at less than 10% interest”. The grant element reflects the financial terms of a transaction: interest rate, maturity (interval to final repayment) and grace period (interval to the first repayment of capital).

In many donor countries, the share of grants in bilateral ODA is close to 100%. The grant element of aid to Least Developed Countries (LDCs) by DAC members is close to 100% (OECD 2010: 222). Similarly, the World Bank has a concessional fund for low-income countries, the International Development Association (IDA), while the EU only makes grants.

Loans therefore can be concessional vs. non-concessional. Concessional loans are loans where the grant element is of 25% or more, and non-concessional loans have a grant element of less than 25%. The concept of aid is therefore associated with the notion of concessionality. The level of concessionality measures “the ‘softness’ of a credit reflecting the benefit to the borrower compared to a loan at market rate. Technically, it is calculated as the difference between the nominal value of a tied aid credit and the present value of the debt service as of the date of disbursement, calculated at a discount rate applicable to the currency of the transaction and expressed as a percentage of the nominal value”.

Official development assistance (ODA) is given to a list of specific recipient countries that exhibit all ranges of income levels, and not only lower income levels. The DAC uses a ‘List of ODA Recipients’ which it revises every three years. The List shows all countries and territories eligible to receive ODA, i.e. all low and middle-income countries, except G8 members, EU members, and countries with a firm date for entry into the EU.

Countries are divided into income groups based on Gross National Income (GNI) per capita as reported by the World Bank, with the Least Developed Countries (LDCs), as defined by the United Nations, separately identified. The List includes the following categories: the LDCs (Least Developed Countries), i.e. countries being below thresholds established for income, economic diversification and social development; Other LICs (Low-Income Countries), which include all non-LDC countries with per

capita GNI USD 935 or less in 2007 (World Bank Atlas basis); LMICs (Lower Middle-Income Countries), i.e. with GNI per capita between USD 936 and USD 3705 in 2007; and UMICs (Upper Middle-Income Countries), i.e. with GNI per capita between USD 3706 and USD 11455 in 2007.

2.2. The variety in types of aid

There are many different types of aid, with different terms and conditions. For example, aid may be tied or untied. Tied aid refers to “Official grants or loans where procurement of the goods or services involved is limited to the donor country or to a group of countries which does not include substantially all aid recipient countries. Tied aid loans, credits and associated financing packages are subject to certain disciplines concerning their concessionality levels, the countries to which they may be directed, and their developmental relevance so as to avoid using aid funds on projects that would be commercially viable with market finance, and to ensure that recipient countries receive good value”. Untied aid refers to “Official Development Assistance for which the associated goods and services may be fully and freely procured in substantially all countries”. Most aid to the Least Developed Countries is now untied by agreement and some donors have untied all their aid.

Likewise, ODA can be made of project assistance or programme assistance. The former has been subject to criticism in the mid-1990s as one of the examples of the disappointing outcomes of aid. The focus of donors has shifted to programme assistance that would not be ex ante earmarked to specific projects – recipient governments' budget support being an example³ –, which is an illustration, among many others, of the variation of the paradigms and conceptual frameworks that have shaped aid over decades.

This shift was associated with another important debate that started in the 2000s within the IFIs, that of the failures of the traditional conditionalities that are linked to aid⁴. This has generated another paradigm change in the 2000s, that of the advantages of aid ‘ownership’ – which has underlain the shift of the IFIs from the stabilisation and adjustment programmes of the 1980s to the Poverty Reduction Strategy Papers (PRSPs) and that of the advantages of ex post conditionality and assessments of aid results, vs. the traditional *ex ante* conditions.

Official Development Assistance comprises several and heterogeneous elements, which may sometimes appear far from the common intuition of aid with its connotation of help or assistance. Bilateral aid, for example, includes technical cooperation, food aid, emergency and distress relief, debt

⁴ The academic and policy literature is very vast; see for example IMF (2005, 2008).

forgiveness and administrative costs, bilateral loans, and bilateral contributions to multilateral institutions (the UN, the World Bank's IDA, the regional development banks...).

The fact that technical cooperation, debt relief or the costs of administering aid are included in the category of aid must be underlined. As highlighted by Sundberg and Gelb (2006), in contrast with what public opinions would expect – and the DAC definition – a large amount of aid is not intended for development: it includes ‘special-purpose’ items such as programme administration, emergency and food assistance, technical cooperation and debt relief. It is the ‘non-special-purpose’ grants that constitute what taxpayers typically consider foreign aid: education, infrastructure, health projects and budget support.

Sundberg and Gelb underscore that over time, this share of aid going to development project and program support has declined during the 1990s due to increases in the share of administrative costs, debt relief and emergency aid. They note that technical cooperation has historically been the second largest component of aid, though experts most often come from donor countries and aid financial flows remain in these donor countries. Administrative costs on bilateral aid have increased in the 2000s to nearly 8% of assistance, due among other causes to the proliferation of agencies and donor countries. To administrative costs must be added the huge administrative burden that aid impose on recipient countries' civil services. In addition, debt relief has increased during the 2000s to some 20% of ODA: as noted by Sundberg and Gelb, however, relief on liabilities that are not being (and often cannot be) serviced does not provide new resources for development, even if it does reduce debt overhang. Emergency and food aid have also increased in the 2000s, and similarly their contribution to long-term development is limited.

3. Global aid flows at the beginning of the 21st century: main facts

The evolution and fluctuations of aid flows at a global scale are presented over the recent decades, the main source being the OECD DAC. It must be underscored, firstly, that aid has been a major source of external finance in low-income countries since the 1970s. Comparing 1991-95 with 1970-75, for low-income countries on average, aid as a share of GDP increased from 6 to almost 15%, while private capital inflows (including FDI) fell from 2 to 1 % of GDP (Morrissey 2004).

3.1. Main trends

According to the OECD-DAC⁵, from 1960 to 1990, ODA flows from DAC countries to developing countries rose steadily. Total ODA as a percentage of DAC countries' combined Gross National Income (GNI), however, fell between 1960 and 1970, and then oscillated between 0.27% and 0.36% for about

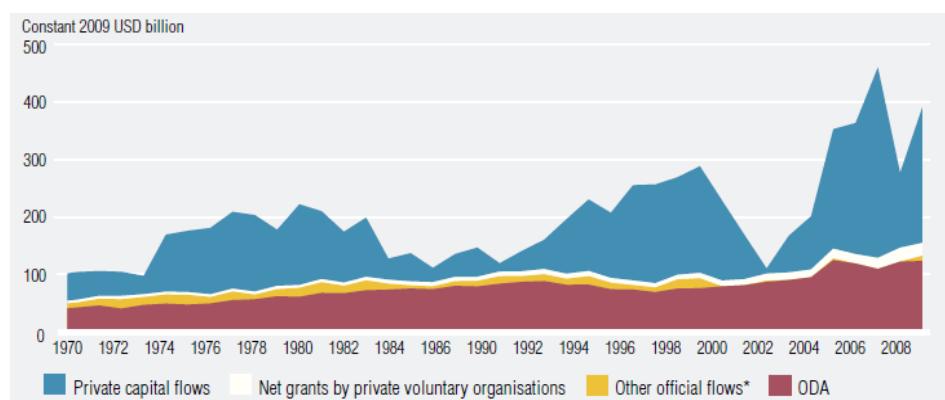
⁵ http://www.oecd.org/document/41/0,3746,en_2649_34447_46195625_1_1_1,00.html

twenty years. Between 1993 and 1997, ODA flows fell by 16% in real terms due to fiscal consolidation in donor countries after the recession of the early 1990s.

Aid then started to rise in real terms in 1998, but was still at its historic low as a share of GNI (0.22%) in 2001. ODA flows then increased after a decade of decline. In 2005, donors made further commitments to increase their aid at the Gleneagles G8 and UN Millennium +5 summits. In 2005 and 2006, aid peaked due to exceptional debt relief operations for Iraq and Nigeria. ODA flows have continued to rise despite the 2008-09 global financial crisis and in 2010 reached their highest real level ever at USD 129 billion.

These evolutions over different time spans and involving different aggregates – total resources flows, net ODA – are shown in the figures below.

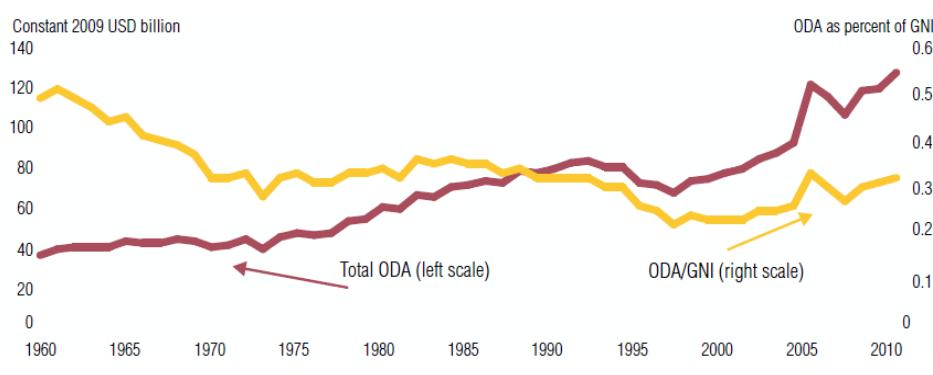
Figure 1: DAC members' total net resource flows to developing countries (1970-2009)



Source: OECD 2011: 222 (Net OOF flows were negative in 2000-01, 2004 and 2006-07).

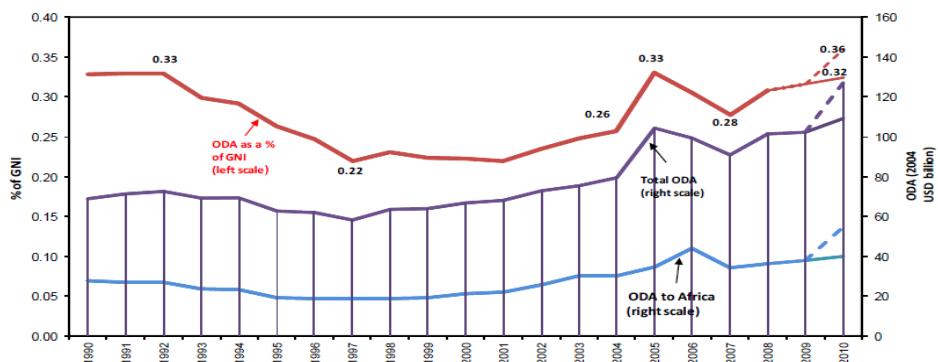
The figures below show the ups and downs of aid over the last 50 years. As underscored by the OECD's Development Co-operation Report (2011), ODA increased in real terms since the 1960s, despite the mid-1990 post-recession fiscal consolidation. The trajectory of ODA as a percentage of GNI is less clear.

Figure 2: Net official development assistance over 50 years (1960-2010)



Source: OECD 2011: 222.

Figure 3: Net Official Development Assistance, 1990-2010, including ODA to Africa



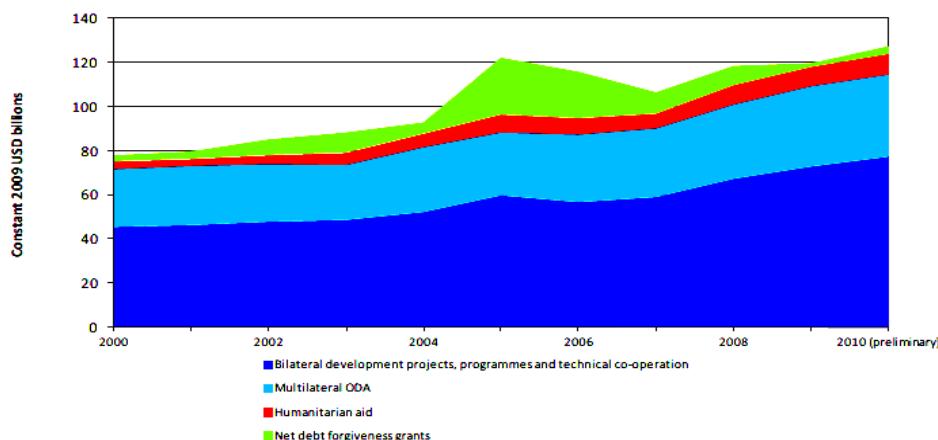
Source: OECD-DAC (2011), Chart 3: <http://www.oecd.org/dataoecd/54/41/47515917.pdf>.

Note: — solid line: actual. - - - dashed line: trajectory envisaged at Gleneagles (adjusted for observed GNI growth).

Assessments obviously depend on the time span. Gupta, Pattillo and Wagh (2006) underscore that the volume of aid has increased during the last four decades, with interruptions in certain years. Over time, the major recipients have changed: the share of aid to Asia has diminished since the 1980s, and aid to SSA has grown. Since the late 1990s, debt relief has assumed a larger share of the increased aid flows to SSA. The share of technical cooperation – a component of aid driven by donors – has risen. The 2000s witnessed an increase in budget support to recipient governments, especially in the form of debt relief.

Official aid flows exhibit significant variations. In the 1990s, aid flows were diverted to transition economies and driven by particular events, e.g. debt relief. Multilateral agencies represent a growing share of total aid.

Figure 4: Components of DAC donors' ODA



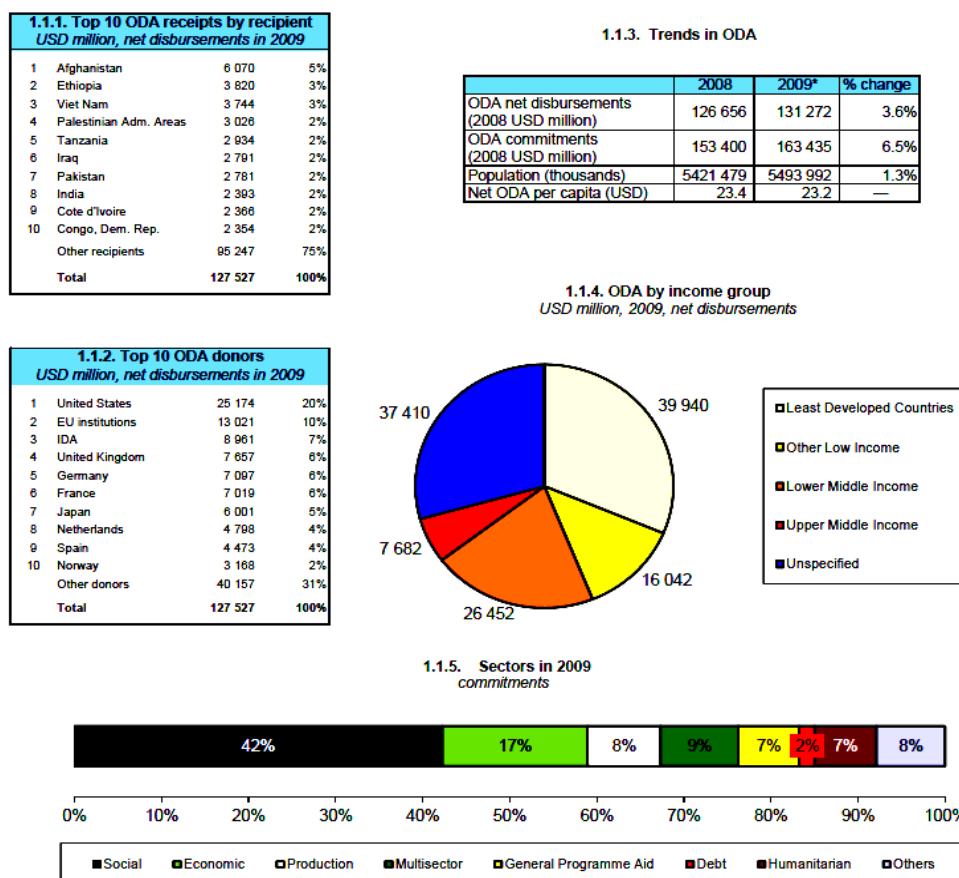
Source: OECD-DAC (2011), Chart 2: <http://www.oecd.org/dataoecd/54/41/47515917.pdf>

According to the OECD-DAC⁶, in 2010, ODA flows from DAC members reached USD 128.7 billion, i.e. an increase of +6.5 % over 2009, and the highest real ODA level ever, surpassing even the volume provided in 2005 which was boosted by exceptional debt relief. Net ODA as a share of gross national

⁶ http://www.oecd.org/document/35/0,3746,en_2649_34447_47515235_1_1_1,00.html

income (GNI) was 0.32%, higher than any other year since 1992. Bilateral aid for development programmes and projects (i.e. excluding debt relief grants and humanitarian aid) rose by +5.9% over 2009, as shown by the figure above. New lending (+13.2%) increased faster than grants (+6.8%). Bilateral ODA to Africa was USD 29.3 billion, of which USD 26.5 billion for SSA, i.e. an increase in real terms of +3.6% and +6.4% respectively over 2009. However, excluding debt relief grants, bilateral ODA fell very slightly (-0.1%) for Africa but rose (+1.7%) for SSA. Aid flows that involve OECD-DAC members are summarised in the figure below.

Figure 5: ODA to developing countries: summary



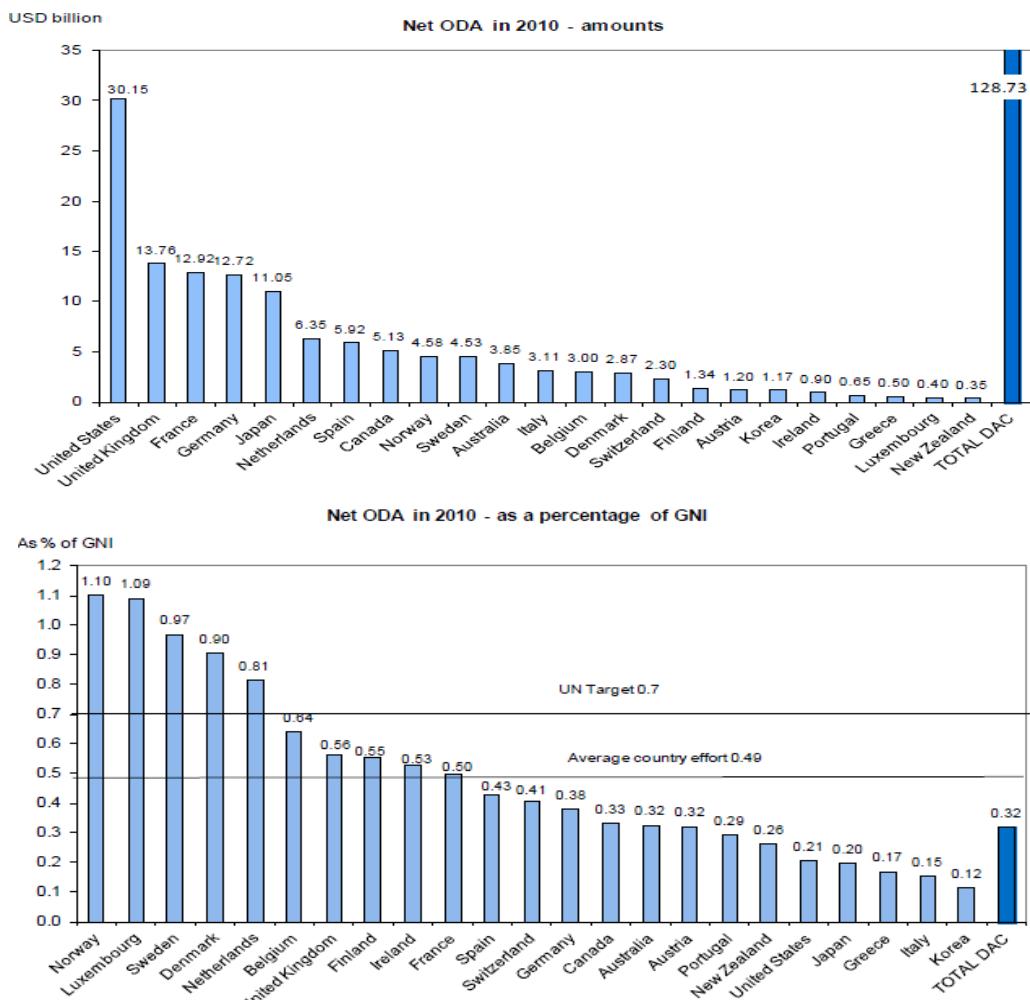
Source: OECD-DCD-DAC 2011a: 2.

As shown by the figures below, there are sharp differences among donors and over time. Quoting the OECD-DAC⁷, in 2010, the largest donors by volume were the United States, the United Kingdom, France, Germany and Japan. Denmark, Luxembourg, the Netherlands, Norway and Sweden continued to exceed to United Nations ODA target of 0.7% of GNI. The United States continued to be the largest single donor with net ODA disbursements of USD 30.2 billion, an increase of +3.5% in real terms over 2009, i.e. the highest real level of ODA ever recorded by a single donor country (except for 2005 when

⁷ http://www.oecd.org/document/35/0,3746,en_2649_34447_47515235_1_1_1,00.html

the US gave exceptional debt relief to Iraq). US ODA remained at 0.21% of GNI. Its bilateral ODA to LDCs rose to a record USD 9.4 billion, an increase of +16.2% over 2009 (due to the 2010 earthquake in Haiti). Among non-LDCs, aid to Pakistan rose sharply (+126% to USD 1.4 billion).

Figure 6: Net official development assistance in 2010



Source: OECD-DAC (2011), Chart 1: <http://www.oecd.org/dataoecd/54/41/47515917.pdf>

The uses of ODA have evolved over time, with, in line with the paradigm of poverty reduction and capacity building of the 2000s, a shift to social and administrative infrastructure.

Table 2: Major aid uses by individual DAC donors (percent of total bilateral commitments)

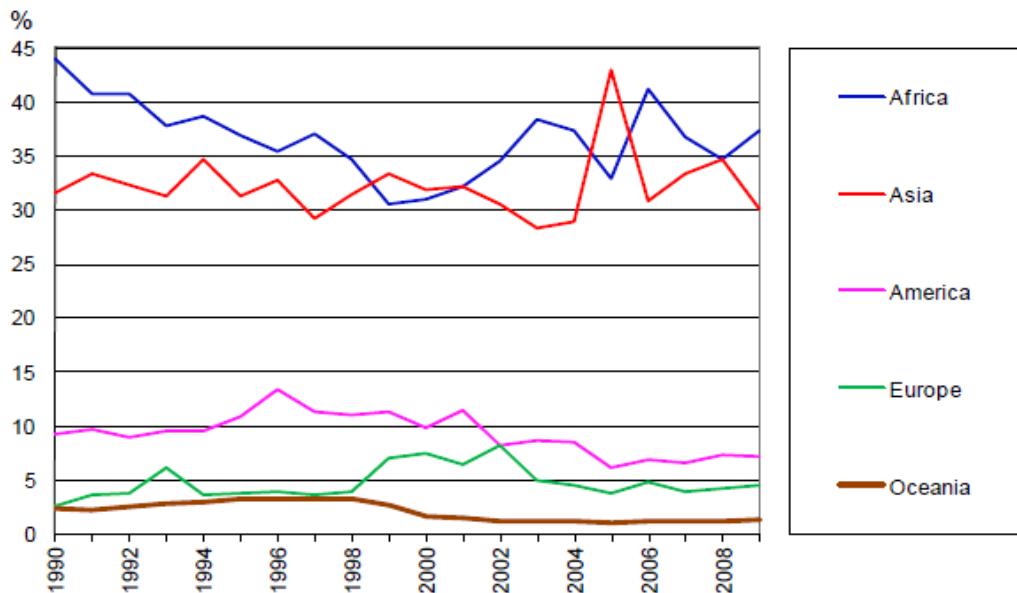
	Social and administrative infrastructure		Economic infrastructure		Agriculture		Industry and other production		Commodity aid and programme assistance		Humanitarian aid		Other	
	1987-88	2007-08	1987-88	2007-08	1987-88	2007-08	1987-88	2007-08	1987-88	2007-08	1987-88	2007-08	1987-88	2007-08
Total DAC	24,4	39,8	22,5	14,7	11,2	4,4	7,0	1,9	19,3	4,8	1,5	7,6	14,1	26,7

Source: OECD 2010: 218f.

3.2. The case of Sub-Saharan Africa

The largest share of ODA goes to two regions, Africa and Asia.

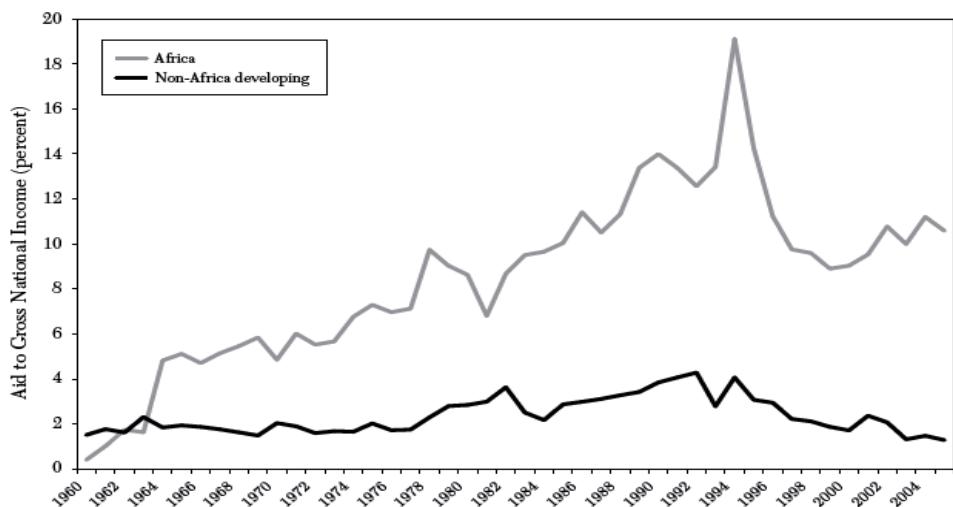
Figure 7: Regional shares of total net ODA, as a percentage of total ODA



Source: OECD-DCD-DAC 2011a: 3.

Over the last five decades, SSA stands as the most aided region. Aid has been a key source of financing in SSA since the 1960s.

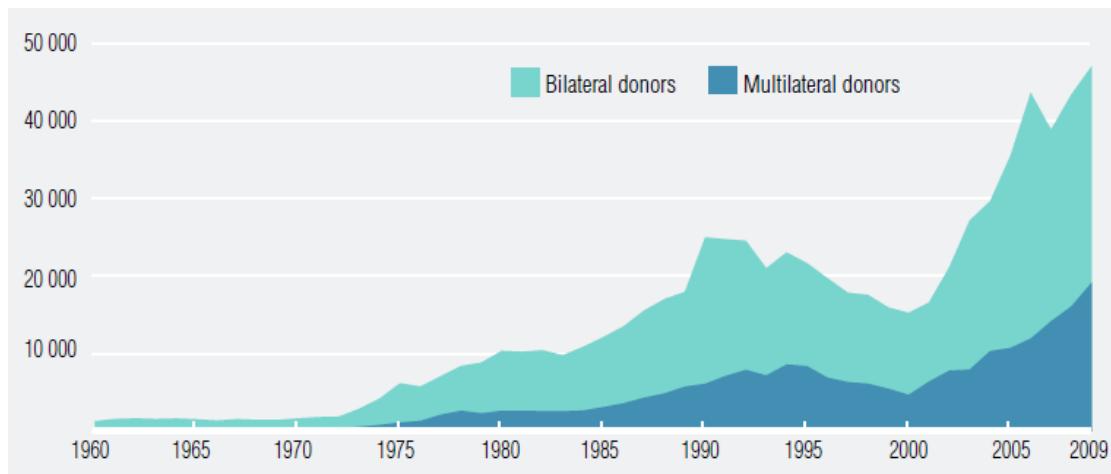
Figure 8: Aid to Africa in International perspective



Source: Easterly 2009: 383.

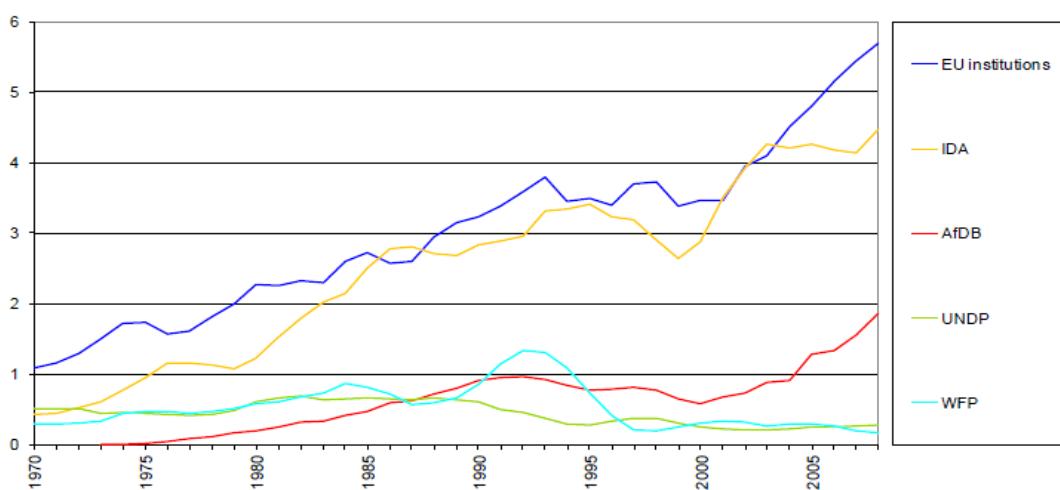
According to the OECD-DAC⁸, over 2007-09 on average, the main donors to Africa by amount were the United States, then the EU, then the World Bank (IDA), then France, the United Kingdom, the African Development Bank, Germany, the IMF, and others countries. Indeed, a characteristic of Sub-Saharan Africa is that multilateral donors play a key role, in particular the EU.

Figure 9: Net disbursements of official development assistance to Africa by donors (current USD million)



Source: OECD 2011: 59.

Figure 10: ODA to Africa by largest multilateral donors since 1970 (USD billion, 2008 prices and exchange rates, 3-year average net disbursement)

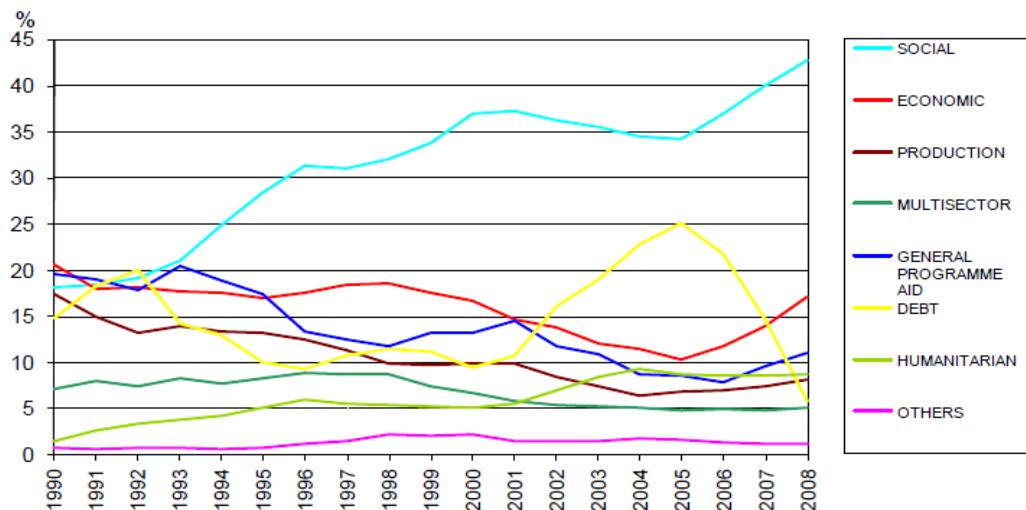


Source: OECD-DCD-DAC 2011b: 6.

Aid to Sub-Saharan Africa has been strongly influenced by the paradigm of poverty reduction that is dominant since the 2000s across all multilateral and bilateral donors, which has been driven by the World Bank and some bilateral countries such as the Scandinavian countries and the United Kingdom (Sindzingre 2004, 2008). Aid increasingly goes to social sectors.

⁸ <http://www.oecd.org/dataoecd/40/27/42139250.pdf>

Figure 11: ODA to Africa by sector since 1990 (as a percentage of total ODA to Africa, 3-year average commitments)



Source: OECD-DCD-DAC 2011b: 10.

3.3. The emergence of new donors: the increasing role of China

The international aid landscape is now characterised by the emergence of ‘non traditional’ donors, i.e. who are not members of the OECD DAC - global funds, private foundations and firms, NGOs, bilateral donors (e.g., Brazil, China, India, Russia, Saudi Arabia and other oil countries). Global funds that are focused on specific objectives are increasingly important, for example in the health sector. Private donors, in particular large foundations, now provide a substantial amount of aid, e.g., the Bill & Melinda Gates Foundation (Ahmed 2008). This contributes to the proliferation of donors that simultaneously have smaller shares of total aid.

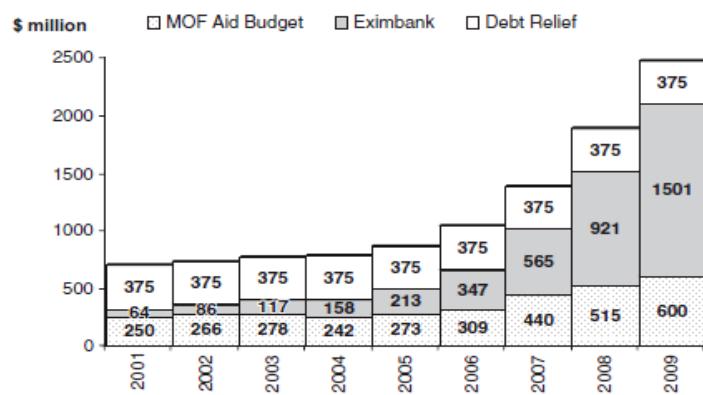
China has become a central donor. Aid is part of a new ‘offensive’ by China and particularly its engagements with SSA (Nissanke/Söderberg 2011), although Chinese aid to SSA is not a recent phenomenon and dates back to the 1960s. As shown by Christensen (2010), aid consists of grants and zero-interest loans from the Ministry of Commerce and concessional loans from China Eximbank. Aid is estimated to have increased from about \$0.3 billion in 2001 to \$2.1 billion in 2009. A large part of this increase is due to concessional Eximbank loans. China mostly gives aid tied to the delivery of Chinese goods and services. China, however, still accounts for less aid than provided by the United Kingdom and Germany, although it is difficult to compare the level of concessionality between China and other donors because of missing information. China differs from traditional donors because the relationship between the government, state enterprises and financial institutions is much closer in China than in other countries: concessional loans are distributed through the China Eximbank, which acknowledges the links between trade, investment and aid (Christensen 2010).

Chinese aid to Africa consists in external assistance, concessional loans and debt relief made by China’s Eximbank. Much of concessional loans go to transport, electricity and infrastructure. China also

combines aid and economic cooperation via joint ventures, cooperation contracts, and public-private partnerships (Fan/Nestorova/Olofinbiyi 2010). In Africa in particular, China uses original contractual relationships that mix aid, foreign direct investment and trade (Sindzingre 2011). These are coined as the ‘Angola model’ (Davies 2010; Corkin 2011). SSA countries barter natural resource exports for investment in infrastructure by Chinese firms: China here bundles ODA-type aid with commercial trade finance in a single transaction; the money from China’s Eximbank does not pass through the host country government and goes directly to the Chinese contractor (Orr/Kennedy 2008).

In her analysis of these original aid packages, Bräutigam (2009, 2010)⁹ shows that the objectives of Chinese aid are firstly the promotion of Chinese business. Chinese aid does include elements that are not viewed as aid by DAC definitions, such as subsidising infrastructure, direct finance to Chinese companies and resource-backed infrastructure loans, which makes quantitative assessments and comparisons with other countries’ aid very difficult, Chinese export credits being for example sometimes confused with grants. China Eximbank export credits are far larger than aid.

Figure 12: China’s aid to Africa, US\$ millions



Source: Brautigam 2009: 170.

4. A key theoretical debate: the impact of aid on the growth of recipient countries

Why aid other countries? A primary justification is that official development assistance is beneficial to the aided country, and at least enhances its growth rates and its level of income. Since the mid-20th century the understanding of foreign aid is based on a series of economic theories and models, which find a positive relationship between aid and recipient countries’ growth (Hansen/Tarp 2000; Tarp 2006). As highlighted by Lucas (1990), for neoclassical theory, capital should flow from rich to poor countries (the ‘Lucas paradox’), and if capital were allowed to flow freely, returns on investment in any location should be the same.

⁹ See also her blog: <http://www.chinaafricarealstory.com/>

These theories, the different channels and impacts, however, are subject to important controversies, a central debate being that on ‘aid effectiveness’ (for a review of the main issues, see Temple 2010). The latter has been increasingly questioned in the academic theoretical literature since the 2000s, while, interestingly, donors’ governments, agencies and policymakers at the same time have augmented their aid and intensified recommendations and promises of increases in aid.

These tensions have been highlighted by Easterly (2009) regarding aid policies. He distinguishes the predominant ‘transformational’ approach (“the West saves developing countries”) from a more ‘marginal’ approach (“the West takes one small step at a time to help individuals in poor countries”). He shows that two themes underlie donors attitudes: “escalation”, i.e. “as each successive Western transformational effort has yielded disappointing results, the response is to try an even more ambitious effort”; and “the cycle of ideas”, i.e. rather than a discarding of failed ideas, ideas going out of fashion come back again when the previous disappointing experience is forgotten. Both attitudes, however, have in common the lack of learning that is characteristic of the ‘transformational’ approach.

4.1. The complex theoretical relationships between aid and growth

For many studies, aid has a positive and statistically significant causal effect on growth over the long run (Arndt/Jones/Tarp 2009).

Historically, the relationships between aid and growth are based on a variety of models. The Harrod (1939)-Domar (1946) model assumes that developing countries are characterised by capital shortage: aid therefore fosters growth by enabling the country to finance more rapid accumulation of capital, supplementing private savings. The effectiveness of aid depends on the productivity of capital (the ICOR); a sustainable growth path may generate a financing gap filled through aid or other forms of financing. The model assumes a stable linear relationship between investment and growth over the short to medium run. This model has been criticised, however, regarding the link investment-growth (constant capital-output ratio). The Harrod-Domar model has been further developed by the Chenery and Strout 1966 ‘two-gaps’ model, which assumes that developing countries are characterised by a savings gap and a trade gap (or foreign exchange gap) (Easterly 1999): it links investment and growth, with the determinants of investment being domestic and foreign savings. The first gap is between the amount of investment necessary to attain a certain rate of growth and domestic savings, and the second gap is the one between import requirements for a given level of production and foreign exchange earnings. Foreign aid may help filling these gaps.

The Harrod-Domar model has been marginalised by the neoclassical growth model and by endogenous growth theory, which consider that physical capital investment is a less important determinant of growth than education and research and question the relationship foreign aid-investment due to aid fungibility (White 1992, 1998). Endogenous growth models emerged in the 1980s

because the Harrod-Domar and Solow models did not explain the persistence of international differences in per capita incomes and growth rates. They explain growth by increasing returns to scale, human capital accumulation and positive externalities (learning by doing), and path-dependent equilibria: here, aid influences growth when it contributes to enhance human capital (education, health) and institutions as the latter influence total factor productivity. Empirical evidence, however, shows that aid has had a limited role in high-growth countries, notably in Asia (White 1998).

Investment is a key channel of transmission in the relationship between aid and growth (Gomanee/Girma/Morrissey 2005). There are debates on this channel, however, given the weak relationship between aid and growth in some regions, in particular in SSA. As shown by Serieux (2009), since the mid-1980s SSA has had the lowest savings and investment rates of any region in the world, while being at the same time the recipient of the highest levels of ODA relative to output: ODA might be having a negative impact on domestic savings. Many analyses presume that aid can be used for either domestic consumption or investment. For Serieux, these analyses are incomplete because they rest on the assumption that ODA stays within the developing country: but a significant part of ODA may go out of the country without having had any impact on either domestic consumption or investment, e.g., in order to reduce foreign liabilities (e.g., by paying interest on foreign debt), or take the form of net acquisition of foreign assets by the private sector (capital flight) or by the public sector (reserve accumulation).

4.2. An important dimension of the debates on the relationship aid-growth: aid effectiveness

The concept of ‘aid effectiveness’ implies that aid is positively related to growth. The question as to whether aid is effective is a central debate, and the reflection on aid ineffectiveness is linked with the notion of ‘aid fatigue’ of the public opinions in donor countries, which has emerged in the 1990s. From the 1990s onwards, debates have been intense on the poor effectiveness of aid (for a review on aid effectiveness, see Doucouliagos/Paldam 2009; Nissanke 2010).

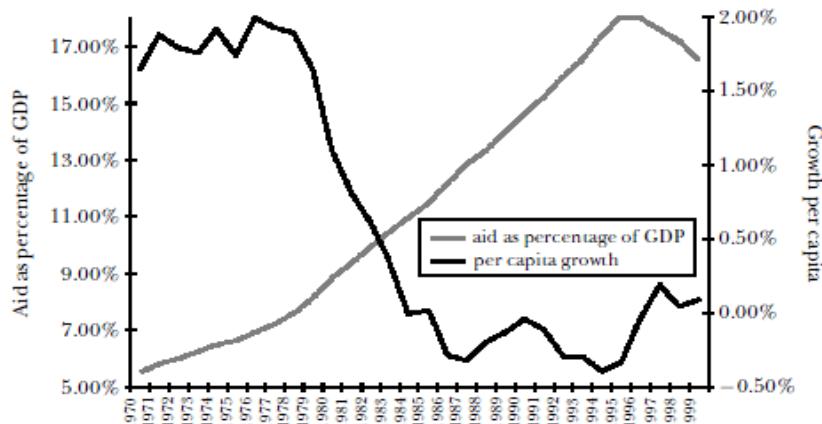
Easterly (2001) has thus argued that USD 1000 billion have been spent by bilateral donors and the IFIs since the 1960s, but that the outcome has been a failure and with aid being driven by ‘fads’. Among these fads are “institutional democracy”, “independent judiciaries”, “decentralisation” and the like. He notes that in the 1980s and 1990s, the IFIs made 958 conditional loans; during the 1990s, they gave 10 or more conditional loans each to 36 poor countries, “even if government mismanagement continued”. For Easterly, the growth rate of income per person of the typical member of this group during the 1980s-90s was zero. The conditions on the loans were not enforced: multilateral and bilateral agencies are responsible: agencies had incentives to continue lending even when recipient governments do not implement policy supposed to improve growth. For Easterly, donors and multilateral agencies gave aid and loans only because their function is to give aid and loans. The conditional debt forgiveness

packages of the 2000s demonstrated that the previous conditional loans had not worked, but donors have an interest in “overselling solutions”, such as “contract enforcement”, “accountability”, ‘political stability’ and so on.

Easterly develops these arguments in many other studies¹⁰, e.g., Easterly (2006), which highlights the misuse of aid funds and corruption. Similarly, for Easterly (2007a), aid has failed to achieve development. He calculates that over the past 42 years, 568 billion USD (in today’s dollars) has flowed into Africa, while the per capita growth of the median African country has been close to zero. The top quarter of aid recipients (most being in Africa) received 17% of their GDP in aid over those 42 years, yet they had near-zero per capita growth. He argues that there are no examples of development due to a large inflow of aid and technical assistance: South Korea took off after aid was reduced, and did not follow donors’ policy advice.

Easterly (2003a) thus demonstrates that the empirical literature on the links aid-growth lacks a clear theoretical model by which aid would influence growth, and that there is no relationship between aid and growth. In the same perspective, Boone (1996) similarly finds that aid finances consumption rather than growth.

Figure 13: Aid and growth in Africa (10-year moving averages)



Source: Easterly 2003a: 35.

Against such arguments, poor effectiveness of aid and the reasons underlying the ambiguous results are explained by Bourguignon and Sundberg (2007) by problems of causality, and the difficulty of attribution of effects – to aid or other causes: they underscore that it is impossible to say how many children are inoculated or crops taken to market due to a dollar of aid.

The IFIs (the IMF and the World Bank) use other arguments. For the World Bank, aid is effective in promoting growth: the culprits are the recipient governments that resisted reforms

¹⁰ See Easterly blog, Aid Watch: <http://aidwatchers.com>

(Dollar/Holmgren/Devarajan 2001). Due to the fungibility of aid, aid is an incentive for recipient governments to reduce their tax efforts. The increasing focus on selectivity from the 1990s onwards intensified the importance given to the ‘quality of governance’ in the recipient countries (Dollar/Levin 2004).

The IFIs have claimed that aid is effective in the presence of “good policies”. A ‘flagship’ paper in this regard has been that by Burnside and Dollar (1997) and the World Bank report by Dollar and Pritchett (1998) “Assessing Aid”. These studies, which are based on cross-country econometrics, conclude that aid raises growth in a “good policy environment”: aid has a positive impact on growth in countries with good fiscal, monetary, and trade policies. In the presence of poor policies, aid has no positive effect on growth. Burnside and Dollar confirmed their results in a subsequent paper (Burnside/Dollar 2004), where they show that in the 1990s allocation of aid to low-income countries favoured ones with better institutional quality and that this selectivity has demonstrated that aid is more productive in “sound institutional and policy environments”. The Burnside-Dollar paper has had an important influence in the policy-making circles, as it has justified a notion that became very influential in the 2000s, that of the ‘selectivity’ of aid: aid must be given to governments which ‘merit’ aid and implement “good policies” (Collier/Dollar 2002). This approach of aid is prescriptive: aid allocation is optimal in countries with high levels of poverty, low per capita incomes and “sound policies”. Countries with “unsound policies” should receive less aid in the Collier–Dollar selectivity approach, as these regimes lessen aid’s impact on growth and thus poverty.

The survey by McGillivray et al. (2005) discusses the ‘pros’ and ‘cons’ regarding aid over 50 years of research on the macroeconomic impact of aid and underscores that studies until the late 1990s produced either contradictory or inconclusive results. Aid either worked, or it did not. It views the World Bank’s report “Assessing Aid” as a major shift in the literature and argues that research published since that report agrees with its general finding that aid works, to the extent that in its absence growth would be lower.

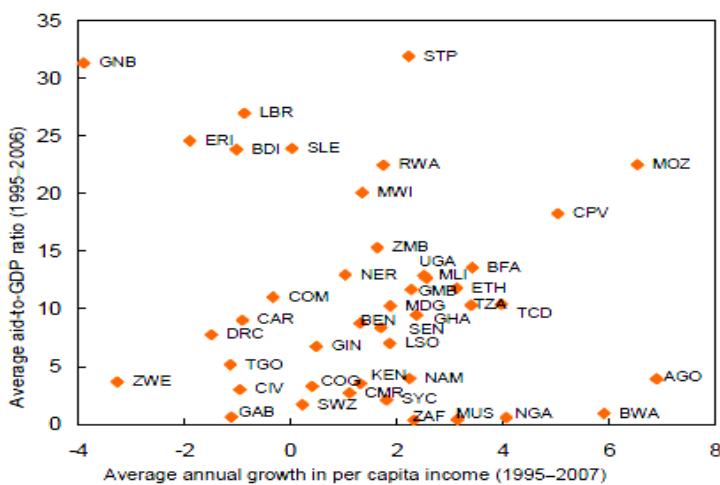
This report has triggered heated debates on the context in which aid works, i.e. whether the effectiveness of aid inflows depends on the policy regime of recipient countries. The Burnside-Dollar theses have been subject to many criticisms, in particular regarding the methodology (Easterly/Levine/Roodman 2003; Roodman 2003/2007; Antipin/Mavrotas 2006; Roodman 2007, 2008). Many studies have questioned the links aid-“good policies”-growth, even from economists close to the World Bank. They argue, for example, that econometric results differ if definitions of ‘policies’, ‘growth’ and ‘aid’ differ.

In fact, the aid-growth relationship may be non-linear: there may be an “aid Laffer curve”, and possible negative returns (Lensink/White 2001): benefits of aid may increase with the initial inflows, but decline after a certain level. There may be threshold effects, diminishing returns of aid, and aid

effectiveness may be greater at lower levels of development. For Kourtellos, Tan and Zhang (2007), however, there is no evidence that the relationship between aid and growth is nonlinear: the partial effect of aid on growth is likely to be weakly negative.

Interestingly, the IMF has also questioned the positive character of the relationship aid-growth. The figure below shows the diversity of experience in the example of SSA: the nature and direction of causality are not indisputably conclusive.

Figure 14: Aid and growth in Sub-Saharan Africa



Source: IMF 2008: 34 (based on Roodman 2006a).

In particular, IMF prominent researchers such as Rajan and Subramanian (2005a) show that there is little robust evidence of a positive (or negative) relationship between aid inflows into a country and its growth, and no evidence that aid works better in better policy or geographical environments, or that certain forms of aid work better than others: aid may lead to the mismanagement of the real exchange rate, which affects the manufacturing sector. Similarly, Rajan and Subramanian (2005b) wonder why there is no robust effect of aid on the long-term growth of poor countries, even those with “good policies”: they show that aid inflows have systematic adverse effects on a country’s competitiveness, as reflected in a decline in the share of labour-intensive and tradable industries in the manufacturing sector, due to the real exchange rate overvaluation caused by aid inflows. By contrast, private-to-private flows like remittances do not seem to create these adverse effects. Furthermore, Rajan and Subramanian (2009) explore the effects of aid on the growth of manufacturing and confirm that aid inflows have systematic adverse effects on a country’s competitiveness, as reflected in the lower relative growth rate of exportable industries. Similarly, the channel for these effects is the real exchange rate appreciation caused by aid inflows. For Rajan and Subramanian this partially explains the lack of robust evidence that foreign aid helps countries grow.

In addition, the relationship aid-growth is contingent on several factors other than recipient country's policies. For example, it depends on political conditions, and aid effectiveness may negatively depend on political instability (Chauvet/Guillaumont 2002). Rather than policy failure, institutional failure and 'poor governance' may be determinants of aid ineffectiveness. The shift in the 2000s from policy to institutional conditionality makes donors' objectives more complex, i.e. not only temporary policy reform but the building of institutions. Moreover, aid may be effective and well-devised, but external circumstances may change. Equally, aid may be effective in other domains than income (Fielding/McGillivray/Torres 2006): aid impacts on a range of human development indicators, health, education and fertility.

The debate on the relationship aid-growth is also made more complex if one considers that it depends on the type of aid – some may be appropriate, others not. Types of aid flows have to be distinguished for assessing the relationship between aid and growth. Aid is heterogeneous, and governments respond differently according to the nature of the aid inflows. There are many types of aid - technical assistance, food aid, aid to imports, counterpart funds, project aid, programme aid and so on. There is therefore a debate on their respective positive or negative effects, as well as on their effectiveness on the recipient country's fiscal management. For example, food aid is often criticised for its negative effects, such as being often procyclical and harming local agricultural producers in lowering prices. Clemens et al. (2004) distinguish 3 categories of aid: 1) emergency and humanitarian aid (likely to be negatively correlated with growth); 2) aid that affects growth over a long period of time, e.g. aid to support democracy, the environment, health or education (likely to have no relationship to growth in the short-term); 3) aid that stimulates growth within a short-term time span, i.e. 4 years, such as budget and balance of payments support, investments in infrastructure, aid to productive sectors (agriculture, industry). Clemens et al. find a positive causal relationship between aid and growth for this third type of aid over a four-year period (but with diminishing returns).

The fact that aid is allocated under the form of grants or loans may also induce different degrees of effectiveness. Loans may be better suited than grants in promoting recipient governments' budgetary discipline, and grants, soft loans and non-concessional loans have their respective comparative advantage. One-time grants may be more effective than loans rollovers when assistance is unconditional, and the opposite when assistance is conditional (Mourmouras/Mayer 2004). Those criticising grants argue that World Bank IDA credits given to poor countries are already highly concessional – 35-40 years to repay, with 10 years of grace period, while those advocating grants argue that in poor countries, many projects do not generate resources rapidly enough to repay debt, for example health projects.

5. Growing controversies: the negative macroeconomic effects of aid and the problems of aid dependence

An increasing number of studies since the 2000s highlight the negative effects of aid and some of the main channels of these negative effects – aid volatility, weakening of fiscal capacities and institutions –, especially in poor or aid-dependent countries. Aid dependence may lead to vicious circles and ‘aid traps’.

5.1. The excessive aid dependence of some countries

Some countries are excessively dependent on aid, e.g., for budgets, investment, maintenance, infrastructure, health and education. The key indicators of aid dependence are aid as a percentage of GNI; as a percentage of gross capital formation; as a percentage of imports of goods, services and income; and as a percentage of central government expenses.

Sub-Saharan Africa is characterised by high aid dependence. According to the World Bank World Development Indicators (2010), aid in SSA represented 20 USD per capita in 2000 or 4.1% of Gross National Income (GNI); and 49 USD per capita and 4.3% of GNI in 2008. In 2000, aid in SSA represented 23.1% of gross capital formation, and 21.9% in 2008. In 2000, aid in SSA represented 11% of imports of goods, services and income; in 2008, 9.2%. However, some countries exhibit low dependency ratios, e.g., Nigeria or South Africa, and SSA countries are not the worst cases – in Haiti, in 1997, aid represented 93.4% of central government expenditure; in Nicaragua in 2002, 84.9%.

The World Bank is aware of the negative effects of aid dependence: dependence on foreign aid impairs export competitiveness and export-oriented development strategies. Relationships exist between ODA, real exchange rates and non-traditional exports, and unsustainable ODA may cause substantial partial real exchange rate overvaluation (Elbadawi 1999). Substantial aid inflows have effects that are similar to ‘Dutch disease’, in particular the risk of appreciation of the real exchange rate (Killick/Foster 2007; Li/Rowe 2007).

The IMF is also aware of the problems caused by aid dependence, in particular, those related to problems of Dutch disease. Many IMF studies underscore that aid surges and aid ‘surprises’ have negative effects on recipient countries’ fiscal management (Aiyar/Berg/Hussain 2008; Berg/Zanna 2010). The fiscal behaviour of governments receiving aid suggests that aid affects government expenditure because aid recipients have other objectives that differ from those of donors: this is expressed by the concept of aid fungibility. A related key debate refers to the possible crowding out effects of aid for savings, and aid negative effects on budget discipline. Aid also creates incentives for capital flight. Aid may also have negative effects on countries’ indebtedness.

5.2. An important channel of aid dependence negative effects: aid volatility

An issue that triggered much debate in the 2000s is the volatility of donors' aid and its negative effects. Aid volatility has detrimental effects on recipient countries: the analogy is often made with the detrimental impact of windfall gains that stem from commodity price volatility and therefore volatility of commodity-dependent countries' export earnings, which are likely to create 'Dutch disease' effects.

The negative effects of aid volatility have been highlighted in particular by the IMF, especially the problems of managing uncertain flows and those of the absorptive capacity of aid recipient countries. Bulíř and Hamann (2001) show that uncertainty about aid disbursements is large. Moreover, Bulíř and Lane (2002) reveal that aid volatility makes difficult macroeconomic fiscal management and government spending in recipient countries. They show that aid flows are typically unpredictable and even more volatile than fiscal revenues, particularly in highly aid-dependent countries. Aid is also mildly procyclical in the recipient country, and hence welfare-reducing. Bulíř and Hamann (2003) confirm these findings, that volatility and uncertainty of aid flows are a key problem and that aid is more volatile than fiscal revenues. This relative volatility increases with the degree of aid dependency as measured by the aid-to-revenue ratio. They confirm that uncertainty about aid disbursements is large and information content of donors' commitments is very small: commitments by donors consistently exceed disbursements, and therefore aid cannot be predicted reliably on the basis of donors' commitments alone.

The update of Bulíř and Hamann (2008) use new data and three measures of aid instability: relative volatility vis-à-vis fiscal revenue, unpredictability of aid disbursement relative to commitments, and failure of aid to smooth fluctuations in aggregate income. They similarly find that the volatility of aid flows is still much greater than that of domestic revenue and that this difference is not decreasing. Especially in poor, aid-dependent countries, this high volatility makes the macroeconomy difficult to manage. They confirm that aid has been procyclical (and not countercyclical) - aid has failed to act either as a stabilising force or as an insurance mechanism -, and that aid is highly unpredictable.

Martins (2010) also finds that since the 1990s, for both low-income and middle-income developing countries, aid volatility has been an intensifying problem, which is aggravated when aid is unpredictable - i.e. commitments are poor predictors of actual disbursements. He also confirms the procyclical character of aid, i.e. that aid inflows tend to increase when a country's growth is rising but decline when it is falling - the opposite of the optimal pattern.

These problems are particularly clear in SSA: indeed, according to OECD-DAC data, during 1990-2005, on average, annual aid disbursements in SSA deviated from aid commitments by 3.4% of GDP. Countries cannot make full use of aid when it is unpredictable (Celasun/Walliser 2008).

5.3. The negative impact of aid dependence on recipient countries' institutions, in particular taxation

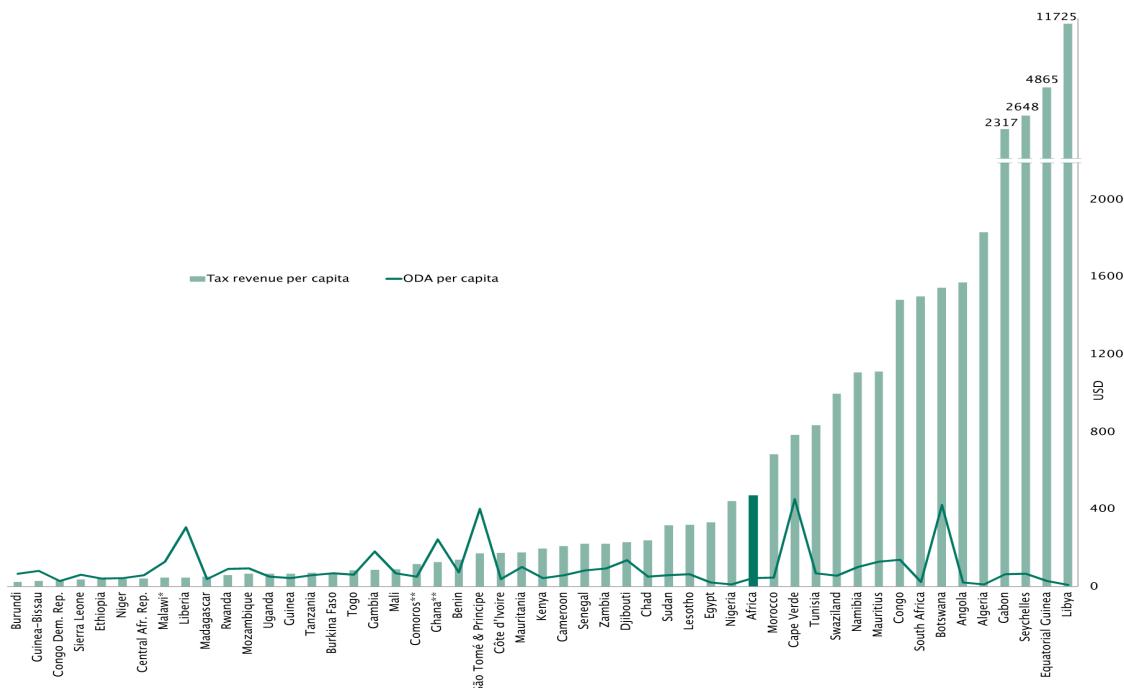
An important problem, which has triggered heated debates, is that aid may undermine institutions and institutional development. Aid dependence creates problems of credibility, incentives and moral hazard in the recipient-donor relationship. Conditionality cannot be efficient, since the aid contract is not time-consistent, which explains the poor results of foreign aid: aid induces weak fiscal discipline and increased fiscal difficulties lead to higher inflow of aid (Svensson 2000).

For the IMF (Rajan/Subramanian 2007), aid may be associated with a weakening of recipient governments' governance, because aid inflows reduce the need for governments to tax the governed. Capital scarcity is a cause of slow growth, but the form in which the capital is received may have adverse spillover effects. Indeed, if aid reduces competitiveness by inflating the exchange rate, or if aid reduces the efficiency of manufacturing investment by adversely affecting governance and thus contracting, then aid may reduce the profitability of investment and limit growth. Aid may also induce a brain drain of human capital, replaced by costly and often inefficient technical assistance – sometimes financed by loans.

Likewise, Moss, Pettersson and van de Walle (2006) demonstrate the negative effects of aid dependence on state institutions and fiscal revenues. They show that aid dependence has an impact on the relationship between state and citizens: states which can raise a substantial proportion of their revenues from aid are less accountable, under less pressure to maintain legitimacy, less likely to have the incentives to invest in effective public institutions. In the same vein, aid increases undermine institutions and taxation capacity, and, as shown by Moss and Subramanian (2005), they have a negative influence on incentives for institutional development and on the accountability of state institutions to their own populations.

For example, in many of Africa's low-income oil importers, domestic revenue mobilisation has not kept pace with rising public spending, and a growing share of current spending is therefore financed by aid: as noted by Gupta and Tareq (2008), from 1997-99 to 2004-06, the share of current spending financed by aid increased from 16% to 36% in Ghana, from 22% to 40% in Tanzania and from 60% to 70% in Uganda. Aid-financed projects give rise to additional spending (on operations and maintenance), which need to be covered, at least partly, from domestic resources: the country must generate sufficient revenue to finance these expenditures, or the productivity of aid-financed projects suffer (Gupta/Tareq 2008).

Figure 15: Aid and tax revenues per capita in Africa in 2008



Source: OECD and African Development Bank, 2010 African Economic Outlook: <http://www.africaneconomicoutlook.org/en/in-depth/public-resource-mobilisation-and-aid-in-africa>. Notes: (*) 2007, (**) 2006.

Typically, aid may be viewed as a rent, and aid may have the negative effects in terms of political economy that resemble the so-called ‘natural resource curse’ (Auby 2007). Like natural resource rent, aid is a large revenue stream that is detached from the economic activity that generates it, and which generates political contests for its capture. For Auby, these contests orient government incentives into rent-channelling at the expense of wealth creation. In this perspective, aid intended to help collapsed economies runs the risk of just perpetuating rent-seeking.

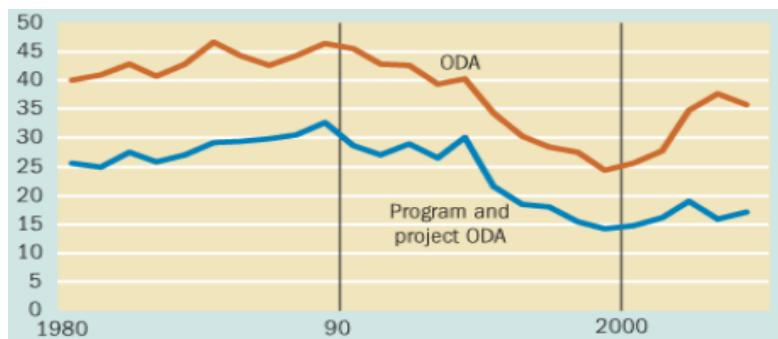
6. The negative effects of aid stemming from the aid relationship: the problems of political economy, incentives and coordination

The theoretical literature has also demonstrated that the impacts of aid are influenced by the characteristics of the aid ‘game’ itself, in particular the features of aid contracts – e.g., conditionalities –, donors’ political objectives and the political economy of recipient countries, and aid fragmentation.

6.1. Political economy as a key dimension of aid

Political economy is indeed an essential dimension of aid, and it explains many aid failures. Aid is not always going to the needy and most deserving countries, besides official targets of reducing poverty and requisites of ‘good governance’. For example, for Sundberg and Gelb (2006), aid took a significant dip after the end of the Cold war.

Figure 16: The impact of realpolitik on aid flows: net per capita ODA flows to SSA, 2004 US dollars

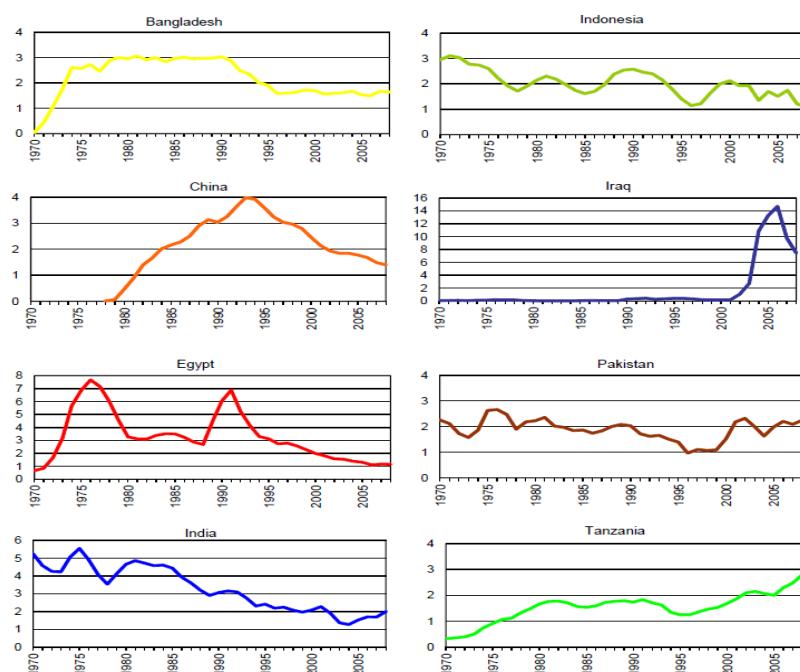


Source: Sundberg/Gelb 2006: 15.

Aid is a dimension of foreign policy in all donor countries. Major recipients of aid have been for the US Egypt, Israel, Pakistan; for the UK, India, Afghanistan, Ghana, Tanzania; for France, Côte d'Ivoire, Cameroon (Alesina/Dollar 1998). Political motives obviously reduce the effectiveness of aid.

As shown by the figure below, aid in the largest recipients exhibit evolutions, which stem from economic causes, e.g. the growth of recipient countries such as China and India, but also geopolitical environments, Iraq being a clear example.

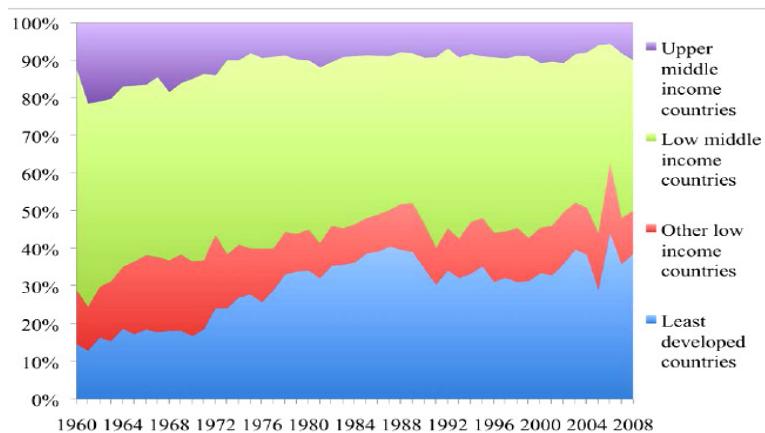
Figure 17: Trends in aid to largest recipients since 1970 (USD billion, 2008 prices and exchange rates, 3-year average net ODA receipts)



Source: OECD-DCD-DAC 2011a: 9.

The situation, however, has improved after the 1980s, as shown by Easterly and Williamson (2011).

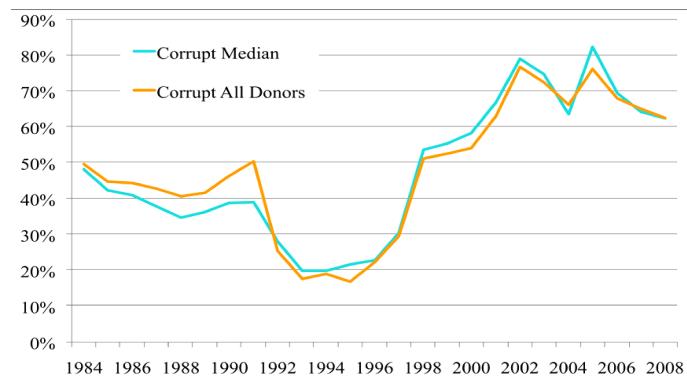
Figure 18: Aid allocation based on income 1960-2008



Source: Easterly/Williamson 2011: 74; data from OECD DAC. Country classification based on OECD; other low income countries=less than \$935 GNI per capita; lower middle income countries=GNI per capita between \$936-3705; upper middle income countries=GNI per capita between \$3706-11455 (2007).

In addition, despite donors' official objectives of 'good governance', corrupt governments receive as much as the less corrupt (Alesina/Weder 1999; Easterly/Williamson 2011).

Figure 19: Share of aid to corrupt countries 1984-2008



Source: Easterly/Williamson 2011: 71; data from ICRG's corruption index.

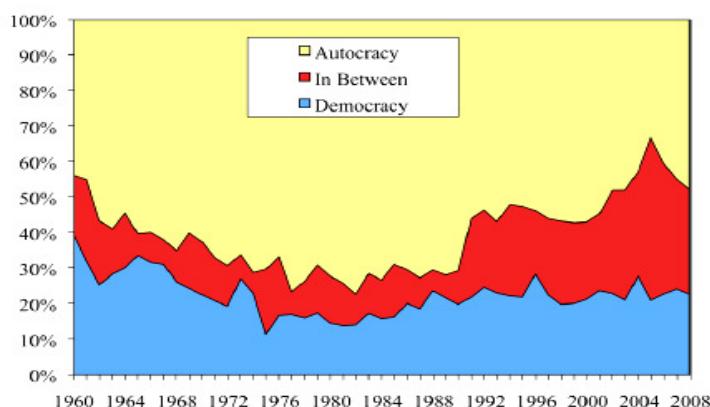
Similarly, despite donors' official objectives and conditionalities regarding the improvement of 'governance' in recipient countries, aid does not go to the most accountable and democratic political regimes.

Table 3: Examples of aid going to autocracies; sum 2004-2008, billion USD

Donors		Recipients	
United States	\$46	China	\$15
Japan	\$23	Vietnam	\$12
Germany	\$16	Sudan	\$10
World Bank (IDA)	\$14	Egypt	\$9
France	\$14	Cameroon	\$9
United Kingdom	\$10	Rwanda	\$5
EC	\$9	Tunisia	\$3

Source: Easterly 2011: 44.

Figure 20: Aid shares by democratic status



Source: Easterly/Williamson 2011: 72; based on Polity IV. The 2005 blip corresponds to debt relief for Iraq and Nigeria.

Political and foreign policy motives cannot be dissociated from economic motives: foreign aid is viewed in some studies as an industry benefiting donors – the ‘aid business’ –, which does not have development as an objective (Raffer/Singer 1996). In this regard, aid has long been ‘tied’, which has been a clear motive of inefficiency. Tied aid conditions financial flows to the purchase of equipment or a technical assistance from the donor country – aid, however, is increasingly untied.

Political economy is one of the determinants of a crucial problem of aid, i.e. the lack of coordination and coherence among donors. The fact that aid is driven by political motives creates incoherence between donors, and therefore this incoherence may be viewed not as an accidental side-effect, but as an intrinsic dimension of aid.

6.2. Divergent incentives and the ‘aid game’

Aid may be viewed as a game with multiple principals (donors), which is characterised by the divergence of the incentives that drive players. This divergence between donors and recipients has negative effects on aid and policy effectiveness. The problem of incentives of recipient governments and more generally of the aid game is compounded by the intrinsic problems of coordination among donors.

Even when made of grants, aid is often subject to conditionality, and therefore suffers from problems that are inherent to conditionality, which induce mixed responses of recipient governments: indeed, there are many debates on the effectiveness of conditional lending. Conditionality is a mechanism that inherently both expresses tensions and triggers in itself resistance. The ‘aid game’, the ‘ritual dance’ may be viewed as an ‘exchange of external finance for economic reform’, as a ‘buying’ of reform, which triggers resistance from governments, and fosters policy reversals. Recipient governments promise the multilateral agencies that this time they would reform (as “alcoholics promising never to drink again”).

Aid may also be used by rulers in recipient countries as an instrument for implementing their own domestic policy according to a ‘double-edged diplomacy’ where aid conditionalities function as ‘scapegoat’, a strategy analysed by Vreeland (1999, 2005).

In the case of conditional lending, on the side of recipients, conditional loans are an element among many others in politicians' incentives, and aid creates conflict over redistribution between groups. Political elites are more focused on power than development. On their side, donors give loans to enable old aid loans to be repaid, keep the cycle of flows working and maintain the activity of aid agencies. Indeed, aid is ineffective because it expresses firstly the objectives of the bureaucracy of aid. For Martens (2005), the role of aid agencies is not so much to transfer funds to developing countries, but to reduce ex-ante transaction costs and to mediate between the diverging preferences of donors and recipients, and package aid flows in a contract that reduces ex-post uncertainties for donors.

Aid is typically affected by the ‘Samaritan dilemma’. As shown by Svensson (2005), the recipient government knows that the foreign aid is governed by poverty alleviation, therefore it has little incentives to exert high effort (or channel its own resources) toward this objective. The recipient government has no interest in encouraging interventions that would reduce poverty if a consequence of these interventions is a diminution of aid in the future. Svensson underscores that the ‘Samaritan’s dilemma’ is made worse by moral hazard problems: the donor cannot distinguish if a poor outcome of an aid project is the result of the recipient country’s low efforts or ‘bad luck’.

6.3. Lack of coordination, fragmentation and proliferation of donors and projects

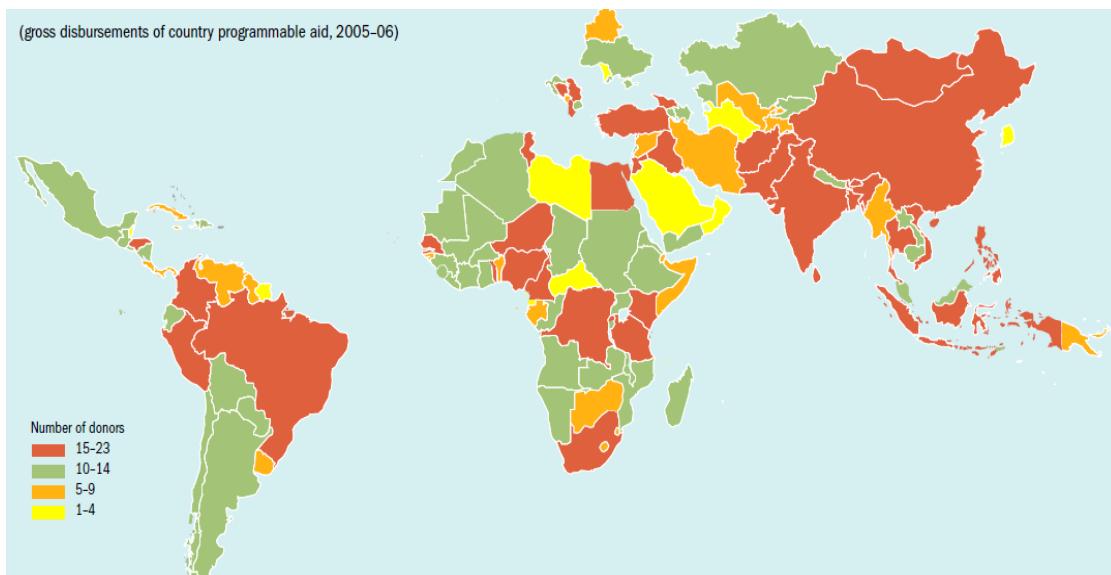
The proliferation of aid agencies, projects, procedures and donor initiatives is a key cause of the detrimental consequences of aid. It generates an intrinsic incoherence that not only affects bilateral donors, but also the IFI and the UN agencies. Important transaction costs and coordination failure stem from the multiplicity of donors, and these costs affect donors as well as recipients. In addition, donors have incomplete information about the other donors’ aid, and these information problems extend to the recipient countries, which are not aware of donor activities in detail *ex ante*, and even *ex post*.

The institutional complexity of the global governance of aid has spectacularly increased and reinforces the lack of coordination and predictability of aid. There has been a continuous increase over time of the number of donors: the average number of donors per country nearly tripled over the last half century, rising from about 12 in the 1960s to about 33 in the 2001-2005 period, and the number of international organisations, funds and programs, about 230, is now higher than the number of developing countries they were created to assist (IDA 2007; Ahmed 2008). This creates not only problems of incoherence and lack of coordination, but an inherent competition between donors.

Another study counts about 280 bilateral donor agencies, 242 multilateral programmes, 24 development banks and about 40 United Nations agencies, which is compounded by an increasing

number of private foundations and NGOs and the proliferation of projects – some 340.000 projects around the world (Deutscher/Fyson 2008).

Figure 21: Aid fragmentation: too many donors contributing too little? Number of donors together providing just one-tenth of a country's aid



Source: Deutscher/Fyson 2008: 17; based on OECD-DAC 2008: vi.

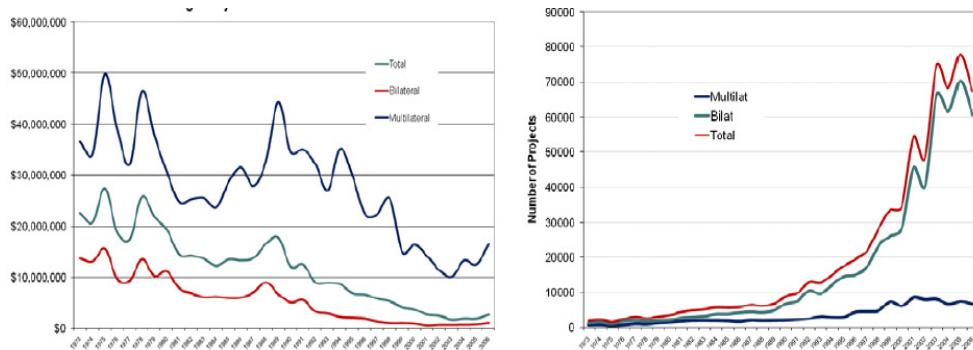
The number of projects nearly tripled between 1995 and 2003 (Roodman 2006b). Likewise, as shown by Killick (2008), the aid system has become intractably complex. Quoting Killick, Uganda has over 40 donors delivering aid in-country. According to the Government of Uganda's own figures, it had to deal with 684 different aid instruments and associated agreements between 2003/2004 and 2006/2007 for aid coming into the central budget alone. A 14-countries survey by the OECD and the World Bank showed an average of 200 donor missions per year, three-quarters of these by a small number of donors. Cambodia and Vietnam received 400 missions each, Nicaragua 289, Bolivia 270 and Bangladesh 250. There are 90 global health funds. St. Vincent, with a population of 117000, was asked to monitor 191 indicators and Guyana, 169 indicators, on HIV/AIDS.

Another example, in Vietnam in 2002, there were 25 official bilateral donors, 19 official multilateral donors and 350 international NGOs, i.e. 8000 projects (Halonen-Akatwijuka 2004). The World Bank (IDA 2007) cites the health sector as an example of the proliferation of aid channels and aid fragmentation, with more than 100 organisations involved. Tanzania may be an example of transaction costs generated by aid, with 700 projects managed by 56 parallel implementation units. Half of all technical assistance is not coordinated with the government and the country received 541 donor missions during 2005, with 17% involving more than one donor.

Aid recipient countries are confronted with multiple donors' requirements and administrative procedures that create a heavy burden on their implementation capacities. Aid implies a detrimental increase in transaction costs for recipient countries and civil services. Donors insist on using their own

processes for implementing and monitoring projects, but aid procedures are not harmonised. According to Sundberg and Gelb (2006), an informal estimate based on a survey of policymakers suggested that as much as half of senior bureaucrats' time in African countries is taken up in dealing with requirements of the aid system and visiting bilateral and multilateral delegations.

Figure 22: Average projects amounts – Number of aid projects, 1973-2006

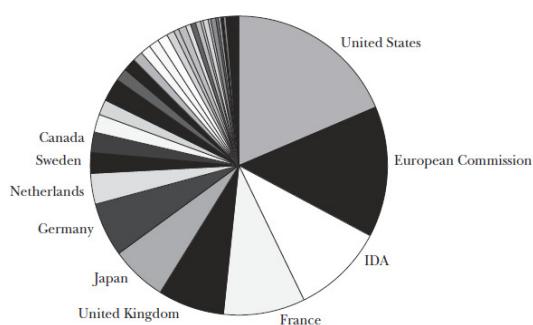


Source: Barder 2009: 6.

William Easterly constantly underscored these problems. He views national and international aid bureaucracies as a failure because they measure output as money disbursed rather than service delivered, produce mostly reports with little ex-post evaluation, without any learning from the past and enormous demands on administrative skills, which are typically scarce in poor countries (Easterly 2003b). Easterly (2005) underscores the innumerable plans assessing 'the need for aid', which firstly justify the existence of the international bureaucracy of aid agencies.

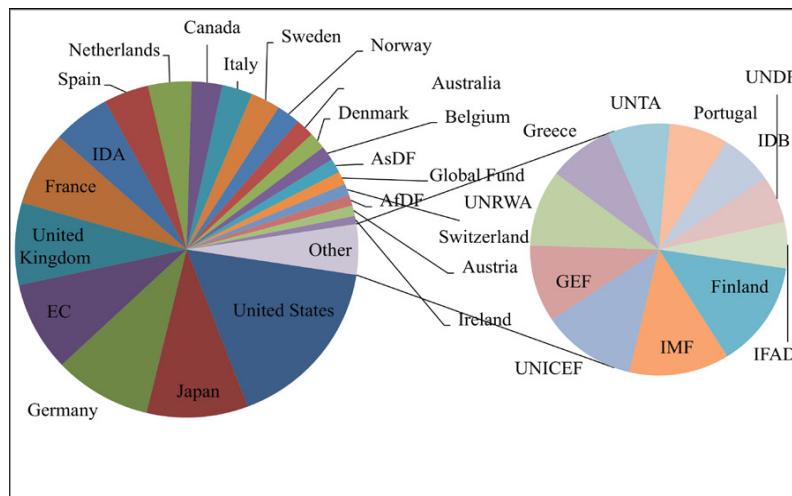
Easterly and Pfutze (2008) note that in 2004, the 10 biggest donors – the US, Japan, IDA, EC, France, United Kingdom, Germany, Netherlands, Sweden, and Canada – accounted for almost 79% of the total, while the 20 smallest agencies account for a total of 6.5% of the total – the multiplication of many small players being understated, because many bilateral donors have more than one agency. Donor fragmentation remains unchanged (Easterly 2007b).

Figure 23: Shares of gross official development assistance in 2004 by donor



Source: Easterly/Pfutze 2008: 39.

Figure 24: Share of Gross ODA by donor, 2008



Source: Easterly/Williamson 2011: 63; based on data from OECD-DAC.

For Easterly (2007b), aid agencies do not learn from experience and new knowledge. Donor fragmentation, unchanged emphasis on technical assistance and the lack of selectivity show the permanence of the status quo and repetition of past mistakes.

7. Conclusion

This paper has revealed that aid has been subject to dramatic evolutions over the recent decades. In order to assess these evolutions, it has emphasised that the knowledge of its various definitions is necessary, as well as its broad mechanisms. It has shown that the theoretical paradigms and key causalities that justify aid are in fact subject to heated debates, in particular regarding the positive impact that aid would have on economic growth.

Since the 2000s, debates are increasingly underscoring the negative consequences of aid. In the context of objectives and policies within the international community that recommend and promise increases in aid, and view aid as the main instrument for low-income countries to enter a development path, theories and policies relative to aid are therefore characterised by tensions and uncertainty.

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