



Overseas Development Institute

**Briefing Paper**

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**AID IN TRANSITION**

*This Briefing Paper assesses the current state of aid from the perspective of the OECD donor countries and reviews the main issues which have led to a reconsideration of the nature and purpose of foreign assistance programmes in several countries. The Briefing Paper examines changes in the international environment for aid provision, investigates the response of donor governments and describes the main factors which are likely to determine future aid policies.*

**The Changing Environment of Aid**

During the period of the Cold War, foreign aid was frequently used to maintain or extend the strategic interests of the major powers. However, for some donors containment of the USSR was not a major preoccupation and it would be misleading to exaggerate the importance of the end of the Cold War.

Nonetheless, a number of other aid-related developments coincided with, or were brought to a head by the ending of the Cold War. These include:

- dilution of development aid budgets by other demands. These demands are no longer just trade promotion and strategic considerations; they now also include environmental spending, humanitarian relief, peace-keeping and the promotion of political transitions to democracy.
- the pressure to divert resources to new claimants among the former COMECON countries, most of which are deemed 'transitional' but include a number of 'developing countries' (see Box 1).
- a loss of confidence in the capacity of parts of the United Nations system to deliver development assistance.
- simultaneously, concern on the part of some donors that their own bilateral programmes are being squeezed by growing, and seemingly unconstrained, international commitments.
- burden-sharing questions, given the realisation that, with the economic collapse of the Soviet Union and the earlier scaling-down of Arab donors' international aid programmes (at least outside the Gulf region), the OECD donors (now 21 with the addition of Spain and Luxembourg, and the readmission of Portugal) are the only major donors left (see Box 2).
- at the same time, the associated phenomenon of new, albeit small, donors emerging (Taiwan, South Korea, Singapore, Turkey), which argues all the more strongly for the richer developing countries to be 'graduated out' of the list of aid recipients. (This argument is strengthened by the results of purchasing-power-parity-based comparisons of countries' domestic product, published in 1993 by the IMF, which has been used to alter the relative rankings of countries. Compared with the traditional concepts of national income, this tends to deflate the per capita income of countries like Russia and inflate that of China and a number of developing countries, with possible implications for aid allocation arrangements).
- the feeling that four decades after the Marshall Plan and three decades on from the foundation of the OECD donors' club, the Development Assistance Committee

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**Box 1: What are developing countries?**

The term 'aid', for international comparison purposes, covers official development assistance (oda) – ie grants or concessionary loans – to 'developing countries and territories'. To qualify, the purpose of such aid must be the promotion of economic development and welfare, but the more controversial area is the list of 'developing countries' agreed by the DAC.

At present the 'Part I' list covers Low-Income Countries (per capita GNP below US\$675 in 1992), Low Middle-Income Countries (\$676–\$2,695), Upper Middle-Income Countries (\$2,696–\$8,355) and High-Income Countries (above \$8,355). The 'Part II' list covers not 'developing countries' but 'countries in transition' (Central and Eastern Europe, some former Soviet Republics and the Baltic States).

The High-Income Country category (which includes Taiwan, Israel, Kuwait, Gibraltar, Falkland Islands and Cyprus) will 'progress to more advanced status' in 1996 (unless exempted by special review); but a number of relatively rich countries in the Upper Middle-Income Country category will remain 'developing countries' for some time. They include Greece, Malta, Barbados and Argentina (all of which are beyond the threshold of World Bank loan eligibility), as well as Brazil, Malaysia, Trinidad and Tobago and Mauritius which still qualify for World Bank loans.

The Low Middle-Income Country category includes Armenia, Georgia, Uzbekistan, Azerbaijan, Kazakhstan, Kyrgyzstan and Turkmenistan as well as a number of countries with considerable potential wealth, such as Papua New Guinea, Namibia and Iraq, and several which would appear to have formidable poverty problems (Côte d'Ivoire, Philippines, Senegal, Jamaica) and curiosities such as the 'Black Communities in South Africa'.

The Low-Income Country category is the most familiar list in terms of aid recipients (Bangladesh, Ethiopia, India, Kenya, etc.) although it also includes countries such as Botswana (due for UMIC reclassification in 1996), Tajikistan and China (where the relevance of per capita GNP as a measure of real wealth has been open to question: see above).

(DAC), the old mechanisms and policies of aid-giving may be anachronistic, especially with a second generation of post-independence leaders less attached to the attractions of being aid recipients. In short, a feeling that aid may be not merely an instrument of the Cold War, but a relic of early post-colonialism.

- competing contenders asserting success as agents of development (especially non-governmental organisations, private capital and individual enterprise) together with new concerns about aid effectiveness, especially in sub-Saharan Africa. With many donors engaged domestically in privatisation programmes and encouraging such policies in East-Central Europe and the former Soviet Union, and professing a strong belief in the power of

## Box 2: Aid from non-DAC countries

The collapse of Communism in Central and Eastern Europe has effectively removed the former COMECON countries as sources of development finance. South-South flows have also fallen as members of the Organisation of Petroleum Exporting Countries (OPEC) have been affected by continuing low oil prices and the consequences of the Gulf War.

On the other hand, Turkey (a non-DAC OECD Member) has been increasing its aid to developing countries, primarily to the new states in Central Asia and the Caucasus. Bilateral aid disbursements in 1993 amounted to \$253 million, up from \$169 million in 1992 and \$103 million in 1991. The Turkish *oda*/GNP ratio in 1993 was approximately 0.22% (excluding aid receipts). Some of the more successful countries in Latin America and the Far East have also provided increased trade financing. According to the DAC, Korean aid in particular continues to increase.

markets, a system whereby development in poor countries was assisted by large injections of international public spending now requires more justification than in the past.

- the power of financial markets. Commercial investment in developing countries (or 'emerging markets') surged in 1992-4. It is not the task of aid to compete with such flows: yet there is a reluctance among official donors to concentrate their aid programmes only on the poorest and least promising countries.

### The Financial Crisis

In financial terms, the 'crisis' in foreign aid has only just dawned. Contrary to general public perceptions, official development assistance (*oda*) grew steadily in real terms at between 2 and 3% per year in the 1970s and 1980s. There was a slight slow-down in the early 1990s, but part of this was due to the falling off in *oda* from OPEC and COMECON. By 1992, *oda*'s growth, in real terms, had fallen below 2% and *oda* peaked at \$60.8bn. In 1993, however, there were substantial real cuts in foreign aid, with DAC *oda* down to \$54.8bn (see Table 1). There was subsequently evidence throughout the July 1994 DAC report on its members' aid policies and performance that new demands were being placed upon aid budgets but that few governments were planning to increase aid expenditure. Several are, in fact, planning further real reductions.

### The Situation Across the Donor Countries

For better or worse, the present moment in development co-operation is one of profound transformation. But the manifestations and perceived causes of this transformation vary significantly among countries.

In the US, now only the second donor and possibly soon to be overtaken by France (see Figure 1), there appears to be a high degree of aid fatigue and loss of public support. However, new constituencies are emerging among a 'Sustainable Development' coalition of NGOs, members of Congress and African-American groups. In Canada, as in the US, there have been substantial cuts in aid but this is less due to aid fatigue (surveys show the majority of Canadians support aid for poor countries) than to a political shift towards domestic spending priorities. In both countries these domestic priorities have crowded out aid budgets. In the US, the legitimacy of spending money

abroad at a time of domestic budgetary cuts is increasingly being questioned.

A critical issue for both the US and Canada is the lack of a consistent rationale for foreign aid and corresponding education of the public on development issues. Aid for development's sake alone is not given high priority among the public and therefore it is easily cut in times of fiscal restraint, despite its relative insignificance in overall budgetary numbers.

In the US, the general public has not been engaged in either the debate about the purpose of aid or the perceived conflicts between 'Third World' development and domestic issues in the North, particularly unemployment. There is concern that domestic self-interest might lead to active public opposition in the face of possible jobless growth, especially when aid rationalised by self-interest fails to produce the promised rewards. The counter trend, of increased concern for global problems (such as the environment, AIDS, drugs, refugees, etc.), has as yet an unclear effect on support for development aid. It is also from the US that the attack on the Bretton Woods institutions, especially the World Bank, is being led. An alliance, initially between environmental groups and pro-poor NGO-based activists in pursuit of a reform agenda, is now evolving into an anti-development (and anti-official aid) movement.

For European countries, there are varied levels of fatigue potential. In general, public support and involvement remain high, countries are outward-looking and aid levels still relatively steady (although set to decline in real terms

Figure 1: Net Aid Disbursements in 1993



Source: OECD

**Table 1: Oda from DAC countries (net disbursements) in US\$ billion**

	1989		1990		1991		1992		1993	
		%		%		%		%		%
	change		change		change		change		change	
<b>Current prices</b>										
Total oda	45.7		53.0		56.7		60.8		54.8	
of which:										
bilateral	32.9		37.2		41.3		41.2		37.6	
to multilateral agencies	12.8		15.8		15.4		19.6		17.2	
<b>1992 prices</b>										
Total oda	56.1	-1.1	58.2	3.7	60.1	3.3	60.8	1.0	56.1	-7.8
of which:										
bilateral	40.1	3.8	40.9	2.1	43.8	6.6	41.2	-6.3	38.4	-7.0
to multilateral agencies	16.0	-13.5	17.3	7.6	16.3	-5.6	19.6	16.5	17.7	-9.5

Source: OECD

in most countries), but many commentators have noted a lack of political leadership (most marked at the centre of the European Union). With the exception of the UK and France, the rationale for aid in European countries is based less on foreign policy concerns than on a commitment to poverty alleviation. With public spending budgets being trimmed, notably in their social welfare components, official aid is liable to be an indirect victim of this policy. Moreover, growing concerns about effectiveness and the spillover from 'fatigued politicians' could eventually undermine public support.

With increasing international involvement in both peace-keeping and aid, the situation in Japan is quite different from that in North America and northern Europe. Public support and interest are high, especially among young people, possibly as a result of the 'lateness' of Japan's entry into international arenas. Support is reflected in new postal savings schemes, whereby Japanese citizens can choose to contribute interest earned on postal accounts to development efforts via organisations which are at least nominally NGOs. There is also increased development education in schools and universities.

An important factor for all countries is the nature of the constituencies and mechanisms for mobilising support. The present circumstances dictate the need for forging broad coalitions, and NGOs are important for constituency building and public education in the North. NGOs are increasingly strong, intellectually and financially, and active in both donor and recipient countries, but a mixed blessing in some. In the US and Canada NGOs have been advocates for reform in the past but are now becoming more narrowly issue-oriented. In the Netherlands, efforts to forge an integrated approach and collective action such as the 'Rainbow Coalition' have been thwarted by divisiveness among NGOs, while critics complain that governments have swung between supporting poverty focus and long-term development on the one hand and conceding the case of oda funds for security and quasi-military purposes on the other.

## Current Issues

### New claims

Assistance to new claimants in East-Central Europe and the former Soviet Union is supported by all major donors, but most accept the case that it should be additional and separate from oda. However, critics also argue that it should be drawn from left-over Cold War defence budgets, or generated from the private sector and then 'married'

with public funds without impinging on the aid budget for Low-Income Countries (see Box 1).

At present, the diversion of oda resources is more potential than real, but the situation varies among donors. It is not currently a problem in Japan. In the US, however, oda diversion has been reflected in cuts to the multilateral development banks in order to fulfil the Clinton Administration's commitment of \$1.8bn in aid to Russia. Even where aid 'pollution' (ie the transferring of other ministries' spending obligations into the development budget) is not immediate (as in the Netherlands and Denmark, where since 1992 there has been a clear distinction between oda and non-oda expenditures), the pressures are real and diversion factors would at the very least be likely to have an impact on the growth of oda. This is particularly so for Germany. Moreover, new subject areas, such as political monitoring and the global environment, have also emerged as claimants for aid allocations.

While the former Soviet Union and the East-Central European countries may eventually return as donors, this will take years; in the meantime, oda budgets will also be pressured by 'legitimate' developing country claimants as a result of newly created nation states, eg Eritrea and perhaps Palestine, and the democratic transformations in others, such as South Africa.

### Global problems

There is widespread consensus on the urgency of addressing global problems such as narcotics, population growth, migration, the environment, and on the importance of the global response. The consensus shows signs of tension at this point, however. The purpose of oda remains, for most donors, the alleviation of poverty in developing countries through the promotion of economic and social development. The existing DAC criteria of aid remain fastidious about developmental purposes, if not especially rigorous on what constitutes a 'developing country' (see Box 1). Furthermore, the poverty-focused framework for aid has long been accepted by most development research centres; the economic arguments in support of aid to developing countries are well rehearsed and generally accepted; and the ethical and redistributive arguments are felt to command widespread public support.

Against this, a minority argues that this framework of aid as a mechanism for addressing the economic problems of poor countries should be treated with increasing scepticism. There is a need to widen the framework of aid provision to incorporate a global (rather than a poor country) agenda.

This would mean oda being deployed to assist in the process of building a new global consensus on such matters as conflict resolution, environmental and demographic challenges, disease control, etc., as well as poverty reduction. The UN Secretary-General's 1994 Agenda for Development (now under revision) is one of the most prominent attempts to rejuvenate development assistance and to lay claim to a wider policy brief. The Dutch Development Cooperation Minister's switch from the pro-poor 'World of Difference' strategy to that of 'A World in Dispute', focusing on aid spending as conflict resolution, is the most striking example of such a transition at the level of a bilateral donor.

The intellectual underpinnings of this broadening of the purpose of aid are becoming increasingly clear. There are, first, arguments (emanating from the UN itself) that 'human security' requires new approaches to sovereignty and peace-keeping and that development assistance should be linked to financing security measures, demobilisation, arms control, etc. Second, there are arguments (particularly evident in the US but also in the European Union) that aid should be used explicitly to promote human rights, democratic forms of government and civil societies (or social cohesion), on the grounds that these represent a new global consensus on 'governance'.

Whether or not these different views on the purpose of aid are in conflict remains a matter for debate. But there is growing concern among development lobbies that a focus on global problems could detract attention from the poorest countries or populations (which are less likely to be the largest contributors to global problems) and that aid allocations governed by this approach might reflect donor countries' perceptions of need rather than those of the recipients.

### Bilateral and multilateral agencies

A more interdependent world without competing superpowers would suggest a greater role for multilateral problem-solving. It is generally agreed that multilateral agencies (and perhaps the regional donors also) have structural advantages over bilateral assistance, which is often criticised as incoherent and too often baldly politicised. Multilaterals may have better potential for consistent, co-ordinated, relatively neutral and universally applied aid. They can avoid the pitfalls of tying and further entanglements. Furthermore, with formal allocative systems such as that of the IDA, based on both need and performance, the multilaterals are often stronger anti-poverty actors than are the bilaterals.

In practice, however, there appear to be weaknesses in the multilateral agencies. Within the UN, critics note unclear objectives and overlapping functions. There are problems with the multilateral development banks, not least the World Bank, regarding an over-emphasis on project design and disbursement at the expense of implementation, a high degree of centralisation with little representation in the field and a lack of accountability and openness in policy dialogue. There is a likelihood of a greater role for the regional banks in the future – especially for regional integration – but they too are seen to need strengthening. Also at hand is the issue of expanded European Union foreign aid programmes. The agreed 60% increase in external affairs spending over the next few years could, unless well-handled, not only exacerbate existing problems

with administration and policy co-ordination but also result in diversion from the bilateral aid programmes of EU members. A clear division of labour between multilaterals and bilaterals is generally held to be desirable (whereby each should focus on and further develop its respective strengths), although it has yet to be achieved. The donors themselves admit that they do not co-ordinate their aid enough.

### Crisis or Opportunity?

Perceptions of a crisis vary across the OECD countries. The Japanese, for instance, do not perceive a crisis in aid, but rather a history of successes (in East Asia) to be duplicated elsewhere. Sceptics, on the other hand, argue that the unique circumstances of the 'Asian miracle' (massive resource transfers, emphasis on human capital, managed trade and the delay in the transition to democracy) suggest that the model may not be so easily applicable elsewhere.

In other countries, the perceived budgetary, intellectual and confidence crisis is real (in the US especially) or potential (in much of Europe). There is wider agreement, however, that the 'crisis', conceived of as a transition to a new pattern of global development, provides an opportunity for a redefinition and revitalisation of development co-operation. In so far as there is a new consensus within the development profession, it is on the content of the three major components of models for development co-operation:

- first, *the rationale*: a common agenda of human development and security which promotes not only economic growth but also democracy, reduced military expenditures and strengthening of institutions (among others), and focuses on issues of employment, migration, population, poverty, the environment, health, social and economic inequity and human rights;
- second, *the governing framework*: a partnership approach with member rights and responsibilities and mutual accountability; and
- third, *the guidelines for resource allocation*: separate and additional funds for new claimants and global problem-solving, with oda reserved for the poorest countries and modelled on the principles of 'real aid': poverty-focused with accelerated graduation; unpolluted, untied, participatory, inclusive of social concerns, and based on coherent donor policies which are transparent and accountable.

These issues are reviewed in more detail in a recent ODI Special Report published with the Overseas Development Council and the North-South Institute. See Hewitt, A. (ed.), *Crisis or Transition in Foreign Aid*, London, Overseas Development Institute, 1994.

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