The Overarching Dilemma Of Aid Is That It Is Needed Most In Those Countries In Which The Prospects For Its Being Most Effective Are The Poorest. Discuss

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It is feasible to argue that in selecting which development strategy to adopt, policymakers depend on a series of factors, whose interrelationships are highlighted in Figure 1. Additionally within this framework, the role and function of foreign aid has been influenced by the factors illustrated in Figure 1. Quintessentially it is perceived that a better understanding of the process of development, will in the long run establish a better appreciation of how foreign aid can best contribute, to the enhancement of developing countries. Following this line of thought the statement that *'the overarching dilemma of aid is that it is needed most in those countries, in which the prospects for its being most effective are the poorest,'* is a succinct explanation of the present point at which foreign aid policy has reached. Quite simply the statement argues that donors are distributing foreign aid, to certain poor countries only. The most prominent justification for this policy action is as the statement suggests, '*the prospects for aid being most effective are the poorest'* in these countries. This paper will ascertain how donors have come to reach this development policy, by analyzing the evolving theories and trends of aid. However this paper will also suggest that the justification, on which the current policy agenda is set, is not founded upon robust assumptions. This paper will then go on to argue that there are other reasons why foreign aid allocation is not going to certain poor countries. The reasoning behind this can be found in analysing the motives of why donors give aid, which range from political to commercial interests.

Size and Distribution of Foreign Aid – How Much do Donors Give and Who Receives it?

From an historical perspective the vast majority of Official Development Assistance (ODA) has been give as bilateral assistance, from one country to another. Yet donors have also provided aid directly to recipient countries through multilateral assistance, which pools together donor resources. In terms of total dollars the United States has traditionally been the largest aid donor, providing for example $11.5 billion in 2001 as Figure 2 indicates. However when donor aid is measured as a % of total donor income, then the USA only provided, "0.18% of GNI in 2006" (OECD, 2008). This amounts to one of the smallest contributions out of all the Development Assistance Committee (DAC) members, with Norway, Netherlands, and Denmark being the most generous, providing between 0.80%-0.81% of their GNI in 2006 (Radelet, 2006 & DAC, 2007).

When assessing the distribution of ODA, Figure 3 accounts for DAC recipients reporting from 2005, 2006, and 2007 flows. Yet Figures 4 and 5 highlight some interesting data. Both bilateral and multilateral aid have been conditioned with several development goals, for better development cooperation that generally gives priority to, aid to the poor. Based on the assumption that the vast majority of the worlds poor reside in Sub-Saharan Africa (Fielding &

Mavrotas, 2005), the data on one hand supports this prioritization, while on the hand it questions its validity. Figure 4 indicates that Sub-Saharan Africa received most aid in between 1989-1999. Though it is true that aid to this region increased in absolute terms, as Figure 5 proves Sub-Saharan Africa's share of $US per capita had fallen by the end of the 1990's, despite many donors declared intentions of giving high priority to this region. This view is supported furthermore by DAC figures, which emphasize that since the 1990's there has been, a reduction in aid in real value to the least developed countries (LDCs). "As a share of total aid, transfers to the LDCs fell from 37% in the mid-80's to 32% by the end of the 1990's" (Degnbol-Martinussen & Engberg-Pedersen, 2003, p.67). The data indicates that the donor agencies are not allocating ODA to certain poor countries. The question is why? This paper will attempt to explain the reason why, by analyzing the evolution of foreign aid policies as well as, donor motives for providing aid.

Evolution of Foreign Aid Policies

In order to explain the justification advocated by donors for not allocating aid to certain poor countries, this paper is obliged to analyse the evolving theories and trends of foreign aid policy. It will do this by looking at both aid development goals and strategies from the 1950's to the present day.

1) 1950s

Development Goal

The objective of the 1950s was to ensure economic growth in the developing countries, in the form of increased production and consumption, which could be measured using GNP. The theoretical framework to support this drive was conceived out of the one sector model, which emphasized the role of investment in the development process. Quite simply in order to ensure the 'big push' or 'take-off into sustained growth' (Thorbecke, 2000), there was a need for an injection of capital into the economy. The reason for this is based on the Harrod – Domar model which stipulates that in order for, "per capita income growth to be positive, a minimum threshold of the investment to GNP ratio is required given the output ratio"(Thorbecke, 2000, p.3).

Development Strategy

The development strategy of the 1950 can be succinctly defined as an 'industrialisation-first strategy.' This placed a great deal on emphasis on the role of industrialisation as acting as the engine of growth, as industry was equated with a high productivity of investment.

Role of Foreign Aid

Foreign aid during the 1950s was seen as the essential source of capital transfer, required to allow developing countries the possibility to attain a high enough savings/investment rate needed to achieve self sustained economic growth (Degnbol-Martinussen & Engberg-Pedersen, 2003).

2) 1960s

Development Goal

Though economic growth remained the central tenant of the development process in the 1960s, there was a realisation amongst the bilateral and multilateral donors that this could not be achieved, through quick capital transfers. Instead the 60s were characterised by the economic dualism framework. This model not only emphasised the importance of two sectors in the development process – industry and agriculture but also their interdependency. What is meant by this is that agriculture played an active and equal role in the growth process, by acting as a supplier of resources into the modern industrial sector.

Development Strategy

The development strategy of the 60s reflected the inter-sectoral development goal, between industry and agriculture. Quite simply strategies were put in place, which saw a balanced allocation of public expenditures between sectors, as well as the implementation of an appropriate price system and the removal of market imperfections.

Role of Foreign Aid

In accordance with the dual economy model foreign aid was considered an important source of either, "removing a savings deficiency through an increased flow of sovereign savings, or a deficit in the current account of the balance-of-payments by providing the necessary foreign exchange" (Thorbecke, 2000, p.6).

3) 1970s

Development Goal

The development goal of the 70s was heavily influenced by the inability of the GNP-orientated development strategy, to ensure the equal distribution of the benefits of economic growth throughout society. Quite simply growth was not having the expected 'trickle down effect' to the poor and as a result, the development goals of the 70s focused on relieving poverty amongst the poor.

Development Strategy

The development strategy of the 70s can shown by the formal shift in the World Bank agenda to include 'redistribution with growth' (Degnbol-Martinussen & Engberg-Pedersen, 2003). This clearly highlights the realisation amongst donors that though growth was important in the development process, growth on its own was not sufficient. As a result there was a shift from a single to multiple development objective, which included factors such as unemployment and the fulfilment of basic welfare needs i.e. health and education. Furthermore the redistribution mechanism was focused in the rural sector, as this is were the majority of the poor lived.

Role of Foreign Aid

The primary role of foreign aid in the 70s was to raise the standard of living and welfare of the poor. This could either be done through the development of employment opportunities, or through increasing the productivity of small hold farmers, beyond subsistence levels.

4) 1980s

Development Goal

A combination of external factors influenced the development objectives, of the 1980s. The two most important were, the extremely heavy foreign debt burden reflected in the large balance-of-payments and budget deficits of developing countries, as well as the combined increase rates and recessions in donor countries. A direct consequence of these events was the weight of importance that donor agencies placed, on developing countries into putting their house in order. In essence the 1980s developing countries had to achieve, "balance-of-payments equilibrium and budget equilibrium" (Thorbecke, 2000, p.9) in order to provide the necessary conditions for economic growth and poverty alleviation. More importantly the donor agencies made this objective a perquisite, before developing countries could resume on the development and poverty alleviation path.

Development Strategy

The development strategies of the 80s were defined by the Washington Consensus. The neoliberal agenda emphasised a reduction of the states economic role, as well as a stronger reliance on free market forces. These two characteristics are intertwined according to neoliberal economists, who deemed state intervention as counterproductive. They accused developing country governments of being bloated, corrupt, and moreover their intervention in the market encouraged rent seeking activities by institutions, which lead to significant economic inefficiencies. Quite simply they advocated that government intervention is not needed as trade liberalisation can induce development, provide for economies of scale and make domestic industries more competitive (Adleman, 2000). This liberalisation of domestic markets was epitomised by the World Banks flagship Structural Adjustment Policies (SAPs), which encouraged domestic structural adjustment in the hope of, reducing balance-of-payments and budget deficits.

Role of Foreign Aid

In wake of the international debt crisis donor aid was readjusted to act as a stop-gap measure, therefore allowing developing countries to re-service their public and private debt. Added to this with a shift in the development goal and strategy, aid was used as a leverage tool in encouraging the, "implementation of appropriate adjustment polices through conditionality attached to programme lending" (Thorbecke, 2000, p.12). In essence there was an *ex ante* framework, whereby the disbursement of aid was conditioned to the promised implementation of specific policy measures or actions (Adam, Chambas, Guillaumount, Jeanneney & Gunning, 2004).

5) 1990s – Present Day

The current aid system which is defined by the statement; *'the overarching dilemma of aid is that it is needed most in those countries, in which the prospects for its being most effective are the poorest,'* has evolved out of the lessons learnt from the aid goals and strategies since the 50s. One of the key observations made was the unequal effectiveness of aid across the developing world. Despite the continued allocation of aid throughout the decades, its effect on stimulating economic growth and alleviating poverty has been varied. On one hand there are clear examples were aid had been a success, such as Bolivia and Ghana in the late 80s, while on the other hand there had been a set of unmitigated failures, such as Zaire under President Mobuto. A consequence of this during the 90s as Figure 6 illustrates, was the phenomenon of 'aid fatigue' (Thorbecke, 2000), which saw a reduction in the amount of aid being provided by donors. However by the mid-90s attempts were being made to rectify the aid effectiveness problem. This attempt saw an ideological shift, which incorporated the philosophy of the Post-Washington Consensus and can be illustrated by the World Bank 1998 report, *Assessing Aid: What Works, What doesn't, and Why*. What this report argues is that ODA continues to play an important role in the development process, in conjunction with free markets. However in order to make aid more effective in reducing poverty and stimulating economic growth, five strategy reforms have to be put into practice;

1) ODA should be allocated more effectively to low-income-countries with sound economic management. Here it is argued that ODA in a good policy environment will act as a catalyst "for faster growth, more rapid gains in social indicators and higher private investments" (World Bank, 1998, p.4) than in a poor policy environment. Therefore unlike before aid should not be equally distributed to all poor countries, but those poor countries with good policies should be given more aid, in comparison to those who do not.

2) "Policy- based aid should be provided to nurture policy reform in credible reformers" (World Bank, 1998, p.4). This reform comes in response to the problem of continued financing and strong conditionality, not instigating reform. The current aid agenda therefore stipulates that aid must be directed to recipients, who illustrate a good track record of reform.

3) ODA should be designed to meet the recipient's, country and sector conditions. Previously despite continued aid financing into individual sectors, improvements were not being made. A major reason for this was that aid is often fungible – whereby donor aid is used to finance government budgets, therefore allowing governments to spend their own money to fulfil their own agendas. As a result, donors must measure the effectiveness of their finance by, "looking at overall allocations as well as the efficacy of public spending" (World Bank, 1998, p.5).

4) Aid activity should be focused on, "creating and transmitting knowledge and capacity" (World Bank, 1998, p.5). As a result development projects should be designed to assist reforms, which improve public service delivery.

5) Aid agencies should move away from the narrow implementation measures of success of the projects they finance, to incorporate alternative approaches in helping highly distorted countries.

From these five development strategies, it is possible to highlight three key development goals, which donor agencies seek to achieve in the current aid agenda.

1) Democratization and Good Governance

In accordance with the Post-Washington Consensus philosophy, the 'good governance' conditionality was added to the requirements which needed to be met, in order to receive aid. The argument of adding this conditionality is that a democratic form of government and good governmental practices, promotes economic development. They argue that "without 'good', or at least 'good enough', governance the fight against poverty cannot be won" (DFID, 2007). This is because government can be held to account by its citizens, for not ensuring that institutions are capable of assisting the market in promoting economic growth, or redistributing the benefits of growth equally across society. Consequently the World Bank advocates that, good governance involves political reforms that ensure that government is made accountable to its citizens, through openness, transparency and equality before the law.

2) Capacity Building

With donors targeting their foreign aid to all aspects of recipient's countries social structures, there is a greater emphasis on developing the recipient countries organisational structure. Donors have therefore expanded the target areas for which their technical assistance is directed towards. In essence it is aimed at supporting the national and local capacity structures in managing development programmes. Capacity-building therefore involves supporting political legitimacy, economic resources, technical solutions, and administrative procedures.

3) Performance-based aid allocation

Performance-based aid allocation or selectivity is a key feature in the donor's development agenda. Though there are differences in defining what criteria's are used to separate who gets aid and who doesn't. For example large bilateral and multilateral donors focus on recipient countries macro policies. They argue that those developing countries who implement proper economic policies, ensure balanced national budgets, limit inflation, encourage private investors and achieve good governance, should receive aid over those countries that do not fulfil these conditionalities. While on the other hand the Scandinavian donors place a greater focus on performance on social terms, especially reducing poverty and promoting human development (Degnbol-Martinussen & Engberg-Pedersen, 2003). By providing aid to those countries that meet their conditions, not only does this show a shift towards *ex post* conditionality, donors also seek to highlight them as role models to other developing countries who fail to adequately meet the set conditionalities. As for those poor countries who do not meet the conditionalities, the donors argue that the best approach is to reduce financing and increase support for policy dialogue and institution building.

By analysing the evolution of foreign aid strategies, this paper has illustrated the donor justification of not allocating aid to certain poor countries.

Criticisms of the Current Aid Agenda

The current donor development strategy, places a great deal of emphasis on the notion of getting institutions right, in order to stimulate economic growth and alleviate poverty. They do so on the basis that there is a proven connection, between democratically accountable regimes and an effective and equally-orientated economic development process. This policy action has been greatly influenced by researchers such as Craig Burnside and David Dollar (2000&2006), who have found a, "positive impact on growth in good policy environments" (Burnside & Dollar, 2000, p.864). They therefore make the policy recommendation that, "making aid more systematically conditional on the quality of policies would likely increase its impact on developing country growth" (Burnside & Dollar, 2000, p.864). Furthermore when Burnside and Dollar revisited their initial proposals they continued to advocate that, "the impact of aid depends on the quality of state institutions and policies" (Burnside & Dollar, 2004, p.2) and for this reason they support the performance-based allocation of aid.

The assumptions made by Burnside and Dollar have been criticised by a number of individuals, for a variety of reasons. For example Jeffery Sachs (2005) argues that instead of thinking about, "how to make poor countries textbook models of good governance, donor agencies should be focusing on the low cost investments e.g. transport and roads, which could alleviate poor countries out of the poverty trap" (Sachs, 2005, p.289). However the biggest criticisms of the Burnside and Dollar have been based on the methodology, used to come to their influential conclusions. Lensink and White (2000) question the variables that were used in the Burnside and Dollar model. They point to the fact that only a few variables such as investment share, robustly effect growth and that these variables are not to be found in the Burnside and Dollar model. As a result they, "suggests that the data do not support the underlying growth model, so one can seriously doubt the relevance of the additional variables included in the regression, such as the variables used in the policy index" (Lensink & White, 2000, p. 7). Easterly, Levine, and Roodman (2003) support this view by arguing that when current data is added to the Burnside and Dollar model, it does not support the conclusion that foreign aid will stimulate growth in countries with good policies.

Donor Motives for Providing ODA

This paper will now analyse why donors provide aid. In doing so this paper will argue that there are other reasons why donors are not allocating aid to certain poor countries.

1) Economic Development

The 1969 Pearson Report advocated that due to the interdependency between the North and South, it was in the best interests of the North to ensure the economic and welfare development of the South, as it was a perquisite to the continued growth in the industrialized North (Pearson, 1969). However what role does foreign aid play in promoting economic growth? According to the Harrod-Domar growth model, in an open economy domestic savings can be contributed to, by many kinds of external assistance. One of which is the role of foreign borrowing in the development process in the form of; "bilateral assistance from developed countries, multilateral assistance and foreign direct investment" (Thirlwall, 2003, p.548). Quite simply foreign borrowing is used by developing countries to act as a supplement to domestic savings, in the attempt to bridge the investment-savings gap and achieve economic growth. According to Hollis Chenery's Dual-Gap Analysis, foreign assistance can also be seen as a replacement to foreign exchange in the process of achieving economic growth, "if the gap between foreign exchange earnings from exports and necessary imports is larger than the domestic investment-savings gap and domestic and foreign resources are not easily sustainable for one another" (Thirlwall, 2003, p.548). The model stipulates that foreign borrowing has to fill the larger of the two gaps to ensure economic growth. Seeing that the majority of developing countries have a dominant foreign exchange gap, the role of foreign aid is to on one hand ensure a boost to domestic savings, while on the other hand provide the required resources to finance the necessary imported goods which are required for economic growth.

This explains why donor countries provide aid to developing countries, but it does not explain the reason why the allocation of donor aid is not reaching certain poor countries. The reason for this is that questions have been raised over the relationship between aid and growth. With more aid expected to lead to faster economic growth, critics have pointed to the fact that certain countries have received a vast amount of aid and have achieved substantial growth, while others have not. As suggested earlier since the mid-90s donors have responded to the unequal effectiveness of aid, by stipulating that aid allocation should favour those countries, which have implemented the appropriate institutions that allow for donor aid to be used effectively. It is for this reason that donors are distributing foreign aid to certain poor countries only.

2) Commercial Interests

Developed countries have also provided aid to developing countries, as a way of improving their own welfare, and such a motivation has formed a tacit basis for choosing recipient countries. The UK as a former colonial empire, has concentrated a vast majority of their foreign aid in their former colonies, as exemplified in Figure 7 with 50% of ODA in 2006 going to former colonies. The reason for this is that it allows them to maintain privileged access, to resources and markets in decolonized areas. Though the USA was itself not a former colonial power, it still has allowed its foreign aid to be dictated by its own commercial considerations. It has ensured its own business interests have been taken care off, by emphasizing that donor US donor aid is tied. This implicitly implies that donors set the condition, that recipients must utilise the grants and loans provided in purchasing goods and services, from the donor country (Hjertholm & White, 2000).

Though certain DAC members, such as the UK and Holland have agreed to untie a certain amount of their foreign aid, "the USA still has over two thirds of its aid tied to purchases in the donor country" (Degnbol-Martinussen & Engberg-Pedersen, 2003, p.14). Seeing that the USA is the largest donor (in terms of total dollars), such policy actions have certain implications. As it is pressurised to give aid to those countries which are deemed lucrative to business, it will keep giving to those countries that have the ability to keep buying to USA products. As Figure 8 illustrates this surmounts to middle-income- countries, hence why it was the largest recipient income group in 2006. Furthermore if Figure 9 is reviewed, it is possible to show that 40% of those recipients are classified as either Lower Middle Income Countries or Upper Middle Income Countries. This clearly indicates that the largest donor provider is implicitly not providing aid to certain poor countries, due to commercial self interest.

3) Political Interests

ODA has also been subject to, the influence of donor national security interests. Some academics would go as far as to say that, foreign policy and political relationships are the most important determinants of aid flows (Radelet, 2006). Perhaps the most illustrative example was during the Cold War, were both the USA and Soviet Union used to vie for the support of developing countries, with little regard to whether the aid was being used to achieve development goals. As Figure 9 highlights a vast amount of USA foreign aid distribution during the Cold War went to Israel and Egypt, as the US provided financial support to back the Camp David peace agreements. Following this general pattern, US foreign aid distribution has now turned to Iraq and Afghanistan, which received "$8,005 million and $1,361million" (OECD, 2008) in 2006 respectively, in order to finance the reconstruction in these countries.

What the statistics insinuate is that though foreign aid is not the central tenant to securing donor countries national security interests, they still play a key role in the process of achieving it. As a result political interests of donor countries are a significant influence in determining were foreign aid is distributed to.

By analysing the motives behind why donors give aid, this paper has found three key factors which determine where aid is allocated to. This paper has found that, it is feasible to argue that donor aid is not going to certain poor countries, not only because it would not be used effectively there, but also because of donor economic, political, and commercial self interest.

Conclusion

In conclusion this paper has attempted to analyse the following statement; *'the overarching dilemma of aid is that it is needed most in those countries, in which the prospects for its being most effective are the poorest.'* In doing so this paper has found that the above statement represents the current donor aid agenda, which states that donor agencies are only allocating aid to certain poor countries. By analysing the evolution of foreign aid theories and trends, this paper ascertained the reasoning behind this viewpoint. It concluded that the agenda has been influenced by research into assessing, why aid has not effected growth and alleviated poverty in all aid recipient countries. The reasons have ranged due to aid fungibility to weak institutional capacity to manage aid. However this paper also showed that there has been criticism of this viewpoint, based on the methodological approach of research to support the current development agenda. Furthermore this paper has concluded that aid is not going to poor countries not only because of the current development agenda, but also because of the commercial, political, and economic self interests of the donor agencies in providing aid.

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