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Article

Development Aid – Between Illusion and Reality

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Maximilian Brucker and
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Development Aid – Between Illusion and Reality

INCREASING EFFORTS EVERYWHERE

Foreign aid² is not only an important source of funding for millions of people suffering from a lack of nutrition, housing or medical treatment during times of crisis but is also given to promote conditions for peace and stability (Arndt and Jones 2015). In times of natural disasters such as the earthquake in Mexico or the hurricane Irma in the United States and Maria in the Caribbean in September 2017, these needs are recognised all over the planet. Media coverage and the willingness to donate money increase significantly during such humanitarian crises. Both private persons and governments donate money and provide resources to rebuild infrastructure and support the population of the crisis-afflicted countries. Governments around the world are judged by politicians and journalists as to whether their support targets the problems that emerge in a proper and immediate way. Such spending forms part of official development assistance (ODA); most aid labelled ODA is planned and contracted in advance. ODA is defined as government aid designed to promote the economic development and welfare of developing countries. Aid may be provided bilaterally, from donor to recipient, or channelled through a multilateral development agency, such as the United Nations or the World Bank” (OECD 2016b). Parts of ODA are given in the

form of loans and infrastructure projects in developing countries. However there are several other forms of aid spending that are summed up as ODA. Since development assistance is a term which is extensively applied to many different aspects of funding, it is necessary to look at actual numbers to assess countries’ generosity. This analysis considers the biggest European donors and the United States in terms of absolute spending in 1995, and compares their progress in terms of aid distributions over the last 20 years. Furthermore, it takes a look at ODA relative to GDP to provide a more realistic picture. The article subsequently discusses aid effectiveness, as well as the evaluation of aid projects. All of the countries considered are development assistance committee (DAC) member countries. The DAC is a subsection of the OECD and comprises of a group of countries that are “defining and monitoring global standards in key areas of development” (OECD 2010). The DAC includes the world’s main donors and helps to coordinate their efforts.

As shown in Table 1, ODA spending has significantly increased in absolute numbers in the last two decades. Moreover, we can see that total foreign aid donated by DAC countries rose from 79,044 million to 141,989 million US dollars in the period from 1995 to 2015, representing an increase of 79.6%. When we look at individual countries, even bigger increases are seen in Germany, Sweden and the United Kingdom, among others. However, there are several countries that seem to have reduced their efforts over the last two decades, namely France and Spain.

A MORE REALISTIC COMPARISON

Given that the absolute numbers do not give a true representation of aid spending due to the different sizes of countries’ economies, it is helpful to look at aid as a percentage of gross national income (GNI). As early as 1970, the richest countries in the world – most of them are now DAC member countries – declared their goal of

¹ ifo Institute (both)

² The terms foreign aid, aid, development aid, development assistance and ODA are used interchangeably.

Table 1

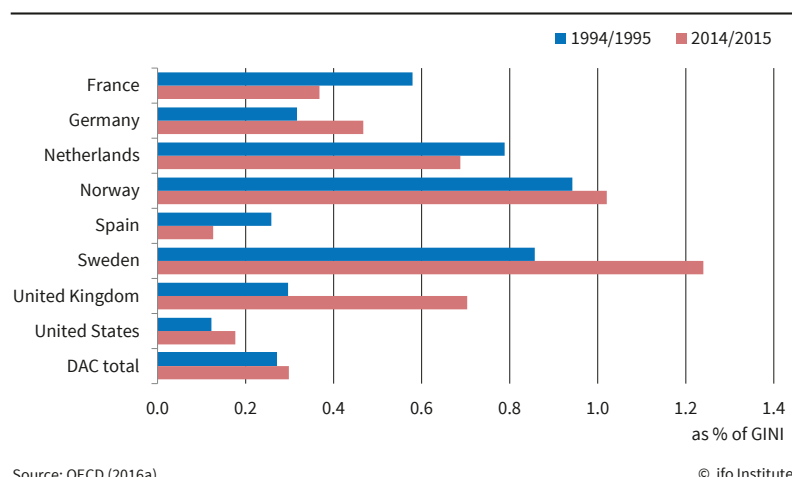
Net ODA spent by DAC country (in million USD at 2014 prices and exchange rates)

| | 1994-1995 | 2004-2005 | 2014-2015 | Percentage change between 94/95 and 14/15 |
|----------------|-----------|------------|------------|---|
| France | 11,763.26 | 11,193.73 | 10,659.26 | -9.39 |
| Germany | 9,013.97 | 10,603.95 | 18,804.96 | 108.62 |
| Netherlands | 4,253.55 | 5,657.15 | 6,200.76 | 45.78 |
| Norway | 2,814.21 | 3,831.68 | 5,306.73 | 88.57 |
| Spain | 2,171.30 | 3,274.84 | 1,767.94 | -18.58 |
| Sweden | 2,597.27 | 3,869.88 | 7,378.10 | 184.07 |
| United Kingdom | 5,335.36 | 10,521.60 | 19,530.00 | 266.05 |
| United States | 12,628.09 | 28,522.53 | 31,885.31 | 152.50 |
| DAC total | 79,043.60 | 113,073.09 | 141,988.63 | 79.63 |

Source: OECD (2016a); authors’ calculations.

Figure 1

Net ODA Disbursements



spending 0.7% of GNI on development assistance annually. This target was to be reached by 1975 and by no means later than 1980 (OECD 2017). In 2005, the EU and their members pledged to increase their aid spending to the 0.7% target, implying that there may have been problems achieving this goal (OECD 2017). Figure 1 presents the share of GNI spent on aid. As can be seen in Figure 1, the DAC countries are not yet close to the target figure, donating only 0.3% of their GNI overall. This number looks even worse in view of the definition of ODA presented above which is more extensive than the definition used in 1970. The current definition of ODA, for instance, has now been extended to include spending on refugees in the donor country. Furthermore, Figure 1 shows that there has been no significant progress in the last two decades. Comparing ODA as a percentage of GNI reveals a slight increase from 0.27% in 1995 to 0.3% in 2015.

However, there are some remarkable outliers among the DAC countries. Most prominently, the Scandinavian countries, Sweden and Norway, both of which spend over 1% of their GNI on development assistance, are positive examples in this respect. Both countries, as well as their Scandinavian neighbours, have a long tradition of comparatively generous aid spending. Other countries have also made progress in recent years. The UK, for instance, increased its aid share from 0.3% in 1995 to the target value of 0.7% in 2015. The reason for the increasing efforts on aid spending in the UK was a law passed by the government in 2010 committing it to match the United Nations' 0.7% goal. This target was achieved for the first time in 2013 (NAO 2017). Although there are positive examples of countries giving more aid than the United Nations' target, some contribute well below the OECD average. The United States, for example, provided a share of just 0.18% of its GNI as foreign aid in 2015, representing a minor increase from its share of 0.12% in 1995. Other countries, including France and Spain, even reduced their spending. Although US spending in aid is already noticeably below

the OECD average, the Trump government is expected to make cuts in this sector. The United Nations responded to those proposed cuts by stating that it would not be able to maintain its essential development programmes in that case, since the US is its biggest single donor (Gladstone 2017). Despite the fact that the US gives the most aid in absolute numbers (Table 1), development spending as a share of its GNI is fairly modest. Different sized economies are one factor explaining the different rankings and trends when comparing Table 1 and Figure 1. Another factor

that may be of less importance in this regard could be economic aspects. Spain, for example, blamed its economic recession in recent years for the drop in its disbursements. Nevertheless, this might not be a very important aspect, because generally for all countries, "total aid accounts for a small fraction of government budgets in donor countries, so that changes in overall budget constraints are less important for explaining the variation in aid flows" (Brech and Potrafke 2014).

AID EFFECTIVENESS

As described in the previous section, aid disbursements are below international targets in terms of percentage of GNI, but in absolute numbers there have been extensive flows in recent decades. It is therefore important to ask whether donors achieved their initial goals of reducing poverty and enhancing economic growth. Easterly (2006) reports that in the past 40 years "\$568 billion [has been] spent on aid to Africa, and yet the typical African country is no richer today than 40 years ago." This calls for an evaluation of former development projects. A first suggestion would be to take a look at ODA distributed to the least developed countries (LDCs). Without going into detailed analyses, one may intuitively assume that those countries need the most support. As shown in Figure 2, only 28% of total aid disbursement is given to those countries, but there are remarkable differences among the different DAC donors, ranging from 14% of Germany's total ODA to 35% for the United States in 2015.³ There is also further evidence that the distribution within a country is not benefitting the poorest. Using household survey data, Briggs (2017) finds that the distribution of aid within a country favours regions with relatively rich people. The author concludes that donors either cannot, or are not willing to control for the allocation within countries.

³ Here only numbers for bilateral aid flows are displayed. The share of aid to LDCs increases for all countries when the multilateral aid flows channeled from a single donor through an international organisation are also considered.

A second recommendation related to the evaluation of aid projects could be to take a look at the decision making process in the planning phase of projects. For example, the Human Development Index (HDI) or literacy rates, among other indicators used currently to identify aid targets, should play a bigger role in the planning process to increase efficiency as those factors are fundamental to the development process in a country. Governments in donor countries also complement those indicators with subjective political consideration. For

instance, by looking at data of the DAC members, Alesina and Dollar (2000) find that countries give more aid to former colonies, and Tingley (2010) suggests that the political ideology of the government (right or left wing) influences aid levels. For the United States, researchers also find that countries' political importance, i.e. their voting powers matter in explaining aid levels. Kuziemko and Werker (2006) conclude that developing nations serving in the United Nations Security Council as a non-permanent member⁴ receive more US aid in the years that they hold a seat.⁵

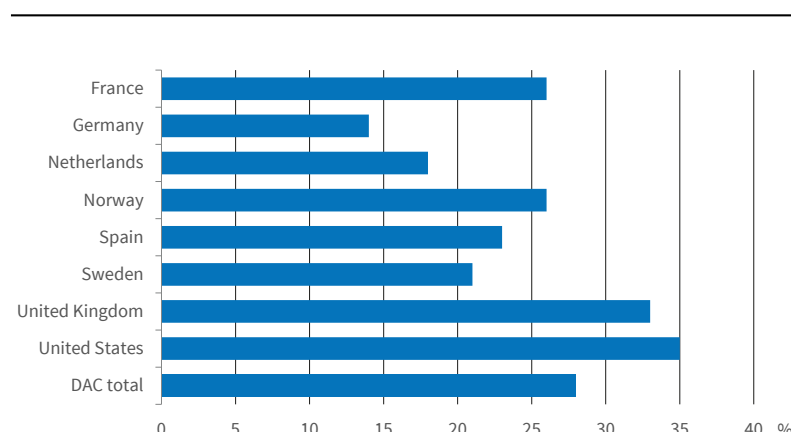
Finally, institutional factors in both donor and recipient countries need to be taken into consideration. Acemoglu and Robinson (2013) conclude that development is predominantly based on a supporting institutional setup in the recipient country. The authors show that extractive governments around the world and political instability lead to huge economic differences in terms of growth and GDP per capita over time. For instance, at the beginning of the 20th century, Argentina was one of the richest countries in the world, on a level comparable to Western-European countries like France and the United Kingdom at that time (Acemoglu and Robinson 2013). However, Argentina is now a rather poor country, with political and economic crises along with bribery and corruption – part of the so called extractive institutions – restraining its prosperous development. The authors conclude that development is largely based on institutions. Similarly, Deaton (2013) observes that a central dilemma for donors is that huge aid flows are not even required when the conditions for development, such as institutions and political factors, are met. As a result, it is crucial to consider the institutional framework and the agendas of political leaders in recipient countries when decisions about official development assistance are being taken.

⁴ The United Nations Security Council consists of five permanent member states and additionally, ten non-permanent members that serve on the council for a two-year term.

⁵ A summary of different aspects determining aid distribution can be found in Fuchs et al. (2014).

Figure 2

ODA Going to LDCs in 2015



Source: OECD (2016a).

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Recalling the example of Acemoglu and Robinson (2013), an evaluation may be easier in retrospect than for upcoming new projects. One possibility for future assessments could be to consider corruption indices, such as the Transparency Internationals Corruption Perception Index, before aid is allocated.⁶

In an ideal setting, all these facets of development assistance should be acknowledged when aid programmes are evaluated and new projects are planned. However, this has not always been the case. Lawson (2016) points out that many programmes have not been assessed at all in the past, explaining why their actual impact is often unclear. An ongoing evaluation process, starting during the planning of the project and continuing at periodical time intervals after the project is finished would lead to meaningful assessments and improve future aid disbursements.

FUTURE RECOMMENDATIONS

What becomes clear is that foreign aid is not only a philanthropic gift to countries and people in need. There are political considerations involved when money is distributed. ODA may be an instrument for connecting and building relationships with foreign governments, rather than serving its actual purpose. Without further analysis of the share of politically-motivated disbursements, it is unlikely that this spending will be redirected or scaled back. The focus should be on direct humanitarian and development aid to people needing it most. As stated above, ODA is unlikely to be distributed to the poorest people within a country and those countries receiving aid might not have the institutional setup for sustained economic growth.

Evaluation schemes should be used to improve the effectiveness of aid and reduce political influence over it. While Lawson (2016) already sees progress in this regard – new evaluation policies for aid have been

⁶ Further information can be found at <https://www.transparency.org/research/cpi/overview>.

established in the US over the past decade – further steps can be taken in terms of data-based assessment. In addition to existing numbers, like the share of people with access to clean water, there is room for new data sources and indicators to detect development projects with a high chance of sustaining success. The most important step in this regard, and one that is comparatively easy to implement, is to rule out the possibility that money is held by recipients' governments and to ensure that it is distributed amongst projects within the country instead. This would eliminate bribery and corruption while boosting efficiency. Many countries and international organisations already work on a project basis, meaning that recipients do not decide on how programme money is spent and projects are funded individually.

Another step in this direction could be the implementation of an independent aid agency, evaluating projects and deciding over future programmes independently of the Ministry of Foreign Affairs. Bertoli et al. (2008) point out that using such institutional setups would lead to aid flows that are less subordinate to electoral cycles and political considerations, and would also lead to more stable aid to GDP ratios. Moreover, the OECD acknowledges and supports this aspect, pointing out that in 2016, 76% of national institutions performed evaluations of former projects, versus just 49% in 2010 (OECD 2016b). It is unfortunate that not all countries have similar institutions in place, but the progress made to date in this area shows that several countries are already trying to adapt.⁷

One final aspect of the institutional framework that might increase the effectiveness of foreign aid is the way disbursements are distributed. Countries should consider channelling more ODA through multi-lateral organisations such as United Nations or the World Bank. Projects undertaken by international organisations may be less prone to political concerns of single donors compared to bilateral aid flows. In 2016, the share of bilateral aid still equalled 72%, leaving significant scope for progress in this context (OECD 2016a). A centralised organisation would further reduce administrative costs and increase the share of development assistance leaving the donor country.

CONCLUSION

To sum up, there are several factors that may increase the effectiveness of aid in developing countries. Since aid disbursements differ between countries, there is no one-size-fits-all approach. Slow changes in the institutional framework of donor countries suggest that there is still scope for progress in the future, which may involve the introduction and further improvement of evaluation schemes. In this area in particular, a committee like DAC can help to assess processes and develop policies that are comparable between coun-

tries. Nevertheless the biggest problem remains aid shares below the international 0.7% target and this issue cannot be addressed by improving institutions in donor or recipient countries. It is an increasing willingness to distribute aid that is required to achieve sustainable progress.

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⁷ The individual institutional framework is summarised in OECD (2009) for all DAC member countries.