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**Working Paper**

## Arab-related bilateral and multilateral sources of development finance: Issues, trends, and the way forward

WIDER Discussion Paper, No. 2002/96

**Provided in Cooperation with:**

United Nations University (UNU), World Institute for Development Economics Research (WIDER)

*Suggested Citation:* Neumayer, Eric (2002) : Arab-related bilateral and multilateral sources of development finance: Issues, trends, and the way forward, WIDER Discussion Paper, No. 2002/96, ISBN 9291903191, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki

This Version is available at:

<https://hdl.handle.net/10419/53012>

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United Nations  
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**WIDER**

World Institute for Development Economics Research

Discussion Paper No. 2002/96

## **Arab-Related Bilateral and Multilateral Sources of Development Finance**

Issues, Trends, and the Way Forward

Eric Neumayer\*

October 2002

### **Abstract**

This article analyses the organizational structure as well as the characteristics of development finance provided by Arab donor countries. This is done with a comparative view in relation to western donors and with the aim to develop recommendations as to how Arab development finance can be strengthened and rendered more effective for the new Millennium. In the 1960s and 1970s Arab donors established a variety of national and multilateral agencies. These agencies share many characteristics of their western counterparts, but some also exhibit distinctive features. Both in terms of absolute volume as well as generosity measured by aid as a percentage of GDP, Arab countries have been important donors in the past, even though recent years have seen a significant fall in Arab aid. Reversing this downfall in aid, targeting its aid better towards the poor and very poor recipient countries and raising the grant share and the concessionality of loans for these countries together with a reallocation of aid towards the social sectors of human development would render Arab aid-giving

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Keywords: aid, official development assistance, Arab agencies, Development Assistance Committee

JEL classification: F34, F35

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This study has been prepared within the UNU/WIDER project on the Sustainability of External Development Financing, which is directed by Matthew Odedokun.

UNU/WIDER gratefully acknowledges the financial contribution to the project by the Ministry for Foreign Affairs of Finland.

more effective in terms of poverty alleviation and more in line with western aid. A greater willingness to participate in the ongoing discussions amongst western donors about the proper objectives and design of development finance would help Arab donors to achieve the recognition they truly deserve. Closer cooperation with western donors would be a logical consequence of taking such a step. However, this would also need to be matched by a greater willingness on the part of western donors to take their Arab counterparts seriously as partners of development finance.

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Camera-ready typescript prepared by Liisa Roponen at UNU/WIDER  
Printed at UNU/WIDER, Helsinki

The views expressed in this publication are those of the author(s). Publication does not imply endorsement by the Institute or the United Nations University, nor by the programme/project sponsors, of any of the views expressed.

ISSN 1609-5774  
ISBN 92-9190-318-3 (printed publication)  
ISBN 92-9190-319-1 (internet publication)

## **1 Introduction**

Arab development finance represents a somewhat neglected aspect. Whilst naturally being much smaller than western aid in absolute terms, Arab countries have been generous donors in the past and an important source of development finance. They are also the only significant providers of development finance other than western developed countries. Similar to the western world, a complex range of national and multilateral agencies have been established to manage Arab aid. After a presentation of the organizational structure of Arab aid and development finance, its characteristics are analysed with a comparative view towards western aid donors, organized in the Organization of Economic Cooperation's Development Assistance Committee (OECD-DAC).<sup>1</sup> Whilst Algeria, Libya, Iraq and Qatar also provide aid, the major Arab donors are Saudi Arabia, Kuwait and the United Arab Emirates (UAE). The other Arab countries are recipient countries rather than donors and not least major recipients of Arab aid.

We analyse Arab aid in terms of motives behind the allocation of aid, absolute volume, relative generosity, allocation across regions and income groups, financial terms, the dependency of recipient countries on aid, the role of export promotion, the sectoral distribution as well as the engagement of donors in discussions of the proper objectives and design of development finance. We mainly concentrate on aid or, in the terminology of the OECD, official development assistance (ODA), which is defined as grants as well as highly concessional loans (that is, loans with a grant element of at least 25 per cent) that are 'undertaken by the official sector', administered with the 'promotion of the economic development and welfare' of the recipient countries as its main objective (OECD 2002b: 294). In the final section we propose various recommendations on how Arab aid can be re-designed for the twenty-first century with a view towards strengthening it and rendering it more effective in terms of poverty alleviation in recipient countries.

## **2 The organizational structure of Arab aid and development finance**

### **2.1 The national agencies**

Kuwait, Saudi Arabia and the United Arab Emirates are the three Arab donors to have national aid agencies. None of the other smaller Arab donors like Algeria, Libya, Iraq or Qatar have such agencies.<sup>2</sup> All three national agencies share a number of characteristics. They provide a whole range of finance to recipient countries, including grants, loans, guarantees and technical assistance. They also channel some of their aid through multilateral agencies, either Arab agencies (discussed further below) or multilateral development banks such as the African Development Bank or the World Bank's International Development Association. This works via contributing to the capital stocks of such agencies. It is noteworthy that often the majority of annual aid allocated

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<sup>1</sup> With the accession of Greece, the OECD-DAC now comprises 22 countries, namely the 15 member countries of the European Union, plus Norway, Switzerland, the United States and Canada, Japan, Australia and New Zealand.

<sup>2</sup> Iraq had an Iraqi Fund for External Development in the 1970s, but it ceased to distribute aid in 1982 (Van den Boogaerde 1991).

by Kuwait, Saudi Arabia and the UAE is *not* channelled through these agencies, but through the Finance Ministry or even some more or less secret funds at the discretion of the ruling families (Nonneman 1988; Van den Boogaerde 1991). This is particularly the case for Saudi Arabia.

### *2.1.1 The Kuwait Fund for Arab Economic Development*

The Kuwait Fund for Arab Economic Development was the first national Arab aid agency to be established in 1961, right at the start of the independence of Kuwait. As its name would suggest, it was initially established to give aid exclusively to Arab countries. However, since 1974 its mandate has been extended to allow provision of aid to all developing countries. The Kuwait Fund has always assumed the role of a kind of role model and pioneer for other Arab aid agencies to follow. It has also taken pride in this role. In a promotional book by McKinnon (1997: 79) it is regarded ‘a testament to the success of the Kuwait Fund that so many other Arab development funds have used it as a model’. It is also the most important national agency providing cumulative gross development finance worth US\$9.3 billion by 1997 (Coordination Secretariat 1998).

### *2.1.2 The Abu Dhabi Fund for Development*

The United Arab Emirates followed the example of Kuwait in creating the Abu Dhabi Fund for Arab Economic Development in 1971. The Fund no longer restricts its aid giving to Arab countries, however, and changed its name to Abu Dhabi Fund for Development. Compared to the Kuwait Fund, the cumulative gross development finance provided until 1997 is relatively small at US\$1.7 billion (Coordination Secretariat 1998).

### *2.1.3 The Saudi Fund for Development*

The Saudi Fund for Development never had a restriction to Arab countries in its name, which is not surprising as at the time of its creation in 1974 Arab donors started to give money to non-Arab countries as well. Of the three national agencies, it is the only one to have inserted the objective of finance and guarantee of Saudi non-oil exports into its Charter. It is therefore more than a pure development finance organization. Its cumulative gross development finance amounts to around US\$6.5 billion by 1997 (Coordination Secretariat 1998). This is clearly lower than the respective figure from the Kuwait Fund. Note, however, that more Saudi Arabian aid and development finance are provided outside the realm of the Saudi Fund than is the case for Kuwait, making Saudi Arabia the biggest Arab donor.

## **2.2 The multilateral agencies**

Multilateral agencies represent the combined and coordinated effort of Arab donors to provide development finance. Contrary to the national agencies, the multilateral agencies provide almost exclusively (low-interest) loans and guarantees, but hardly any grants at all, mostly in the form of technical assistance. Suggestive of such difference is already the fact that some of the multilateral agencies are called banks (Arab Bank for Economic Development in Africa and Islamic Development Bank) rather than funds. We will include here two agencies, namely the Islamic Development Bank and the OPEC Fund for International Development, which strictly speaking are not exclusively Arab multilateral agencies, but the Arab members of both are by far the major contributors.

### *2.2.1 The Arab Fund for Economic and Social Development (AFESD)*

Of the multilateral Arab aid agencies, the AFESD with headquarters in Kuwait City is the oldest and one of the most important one. Its cumulative disbursed gross development finance amounts to around US\$7.8 billion by 2001 (AFESD 2002). Its establishing agreement was signed in 1968, but it started operations only in 1974 (van den Boogaerde 1991). It is an exclusively Arab organization as participating countries must be members of the League of Arab States. Besides project finance, the AFESD also participates in the equity capital of corporations, establishes or administers special funds, promotes inter-Arab investment and provides expertise and technical assistance. It also hosts the Coordination Secretariat for Arab National and Regional Development Institutions (see further below).

### *2.2.2 The Arab Bank for Economic Development in Africa (BADEA)*

BADEA, with headquarters in Khartoum (Sudan), assumed operations in 1975. As its name would suggest, its objective is to provide development finance to countries, which are members of the Organization of African Unity (OAU), but not the League of Arab States. In 1976, BADEA took over the management of the Special Arab Aid Fund for Africa (SAAFA), whose resources were merged with BADEA's in 1977. SAAFA was created in 1973 to help overcome balance of payments difficulties of African countries, particularly with respect to financing oil imports. With the merging into BADEA, this type of development finance was suspended. In 1997, BADEA issued a decision allocating US\$50 million for the finance of Arab-African trade, which is administered by the Islamic Development Bank. By 2000 BADEA had disbursed gross development finance worth US\$1.17 billion (BADEA 2002).

### *2.2.3 The Arab Monetary Fund (AMF) and the Arab Trade Financing Programme (ATFP)*

The AMF, established in 1976 with headquarters in Abu Dhabi (UAE), provides assistance exclusively to Arab countries in order to overcome balance of payments difficulties. It also provides the Secretariat for the Council of Governors of Arab Central Banks and Monetary Agencies and, like the IMF, publishes a joint Arab Economic Report on the state of the economy in member countries. In 1989 it created the ATFP, which provides export and import credits for the promotion of inter-Arab trade. The ATFP also organizes buyer-seller meetings and trade information points as part of its inter-Arab trade information network.

### *2.2.4 The Inter-Arab Investment Guarantee Corporation (IAIGC)*

The IAIGC operates the Arab Investment Guarantee scheme, aimed at encouraging Arab investors to invest in other Arab countries, and the Export Credit Guarantee Scheme, which aims at promoting inter-Arab trade. In addition, the IAIGC promotes inter-Arab investment with a range of schemes aimed at providing information about investment opportunities.

### *2.2.5 The Arab Gulf Programme for United Nations Development Organization (AGFUND)*

Established in 1981 with headquarters in Riyadh (Saudi Arabia), the AGFUND aims to provide finance for social, health, education and other 'soft' sectors in cooperation with United Nations agencies as well as other multilateral and national donors. Van den

Boogaerde (1991: 19) reports that US\$176 million had been disbursed by the AGFUND until 1989. More recent data are not available.

### *2.2.6 The Arab Authority for Agricultural Investment and Development (AAID)*

The AAID with headquarters in Khartoum (Sudan) was established in 1977 in order to boost agricultural production in Arab countries via investments in animal and plant production, agricultural processing and marketing. It is a major shareholder of more than 20 agricultural companies. The concern of Arab countries about agricultural self-sufficiency has prompted them to establish or finance other institutions with agricultural objectives as well. For example, Arab countries have been major contributors to the United Nations International Fund for Agricultural Development (IFAD), established in 1977. Also, one of the minor components of the Islamic Development Bank group is the Biosaline Agriculture Centre in Dubai (UAE), which was established in 1999 and aspires to develop and promote the use of sustainable agriculture using saline water. As we will see further below, around one-fifth of Arab development finance is devoted to agriculture and livestock production.

### *2.2.7 The Islamic Development Bank (IDB)*

The IDB with headquarters in Jeddah (Saudi Arabia) also started operations in 1975. It provides concessionary and non-concessionary loans to member countries of the Organization of the Islamic Conference (OIC). By 2000 its cumulative gross disbursements of development finance had reached US\$14.8 billion (IDB 2002), making it the single biggest Arab agency donor. Like the World Bank Group, the IDB is more a group of development finance organizations with different administrative arrangements and operational rules than one single bank and also calls itself the IDB group. Its main components are the IDB Unit Investment Fund (UIF), the IDB Infrastructure Fund, the Islamic Corporation for Insurance of Investment and Export Credit (ICIEC) and the Islamic Corporation for the Development of Private Sector (ICD). The UIF, established in 1989, is the private sector window of the IDB. One of its main objective is to raise money through several modes of Islamic financing that are compatible with Shari'ah rules, that is, with the beliefs and the rules of conduct mandated by Islam. By far the most important of these Islamic financing modes is Murabaha, where one partner buys a good and sells it on to the other partner on a cost-plus basis with the profit to the seller and repayment by the buyer specified in the initial contract. The IDB Infrastructure Fund was established in 1999 to make equity and equity-related investments in infrastructure projects and infrastructure-related industries. The ICIECD, established in 1984, provides export credit and investment insurance. The ICD was established in 2000 and complements the UIF in providing Shari'ah compatible financial products and services as well as expanding the access of private companies to Islamic capital markets. In addition, the IDB has a trade finance and promotion department whose objective is the promotion of trade among IDB member countries for which import finance (US\$4 billion) and export finance (US\$200 million) are provided. The IDB is also the manager of the Islamic Banks Portfolio for Investment and Development (IBP), established in 1987, which aims to mobilize liquidity for Islamic banks and to develop an Islamic financial market. Of all the Arab and Arab-dominated donors, the IDB group currently seems to be by far the most vibrant and active one, having recently created many special organizations, which extend the IDB's area of activity.

### *2.2.8 The OPEC Fund for International Development (OFID)*

The OFID was established in 1976 and, like the Organization of Petroleum Exporting Countries (OPEC) itself, has its headquarters in Vienna. In addition to the usual project and programme loans, OFID also provides loans for balance of payments support and for debt reduction within the framework of the World Bank's and the IMF's initiative for highly indebted poor countries (HIPC initiative). By 2001 OFID had disbursed gross development finance amounting to US\$3.1 billion (OFID 2002).

### **2.3 The Coordination Secretariat**

In 1975 a Coordination Secretariat for Arab National and Regional Development Institutions was established under the auspices of the AFESD. It brings together the eight most important aid agencies of the Arab world: The Abu Dhabi, Kuwait and Saudi Fund, the AFESD, BADEA, the IDB, the AMF and the OFID. There is substantial co-financing of projects among the agencies of the Coordination Secretariat as well as, albeit less so, with western donors and western-dominated institutions such as the World Bank. However, the Secretariat's objective is very limited. Its main function seems to be to collect and disseminate statistical information about Arab aid giving. It does not have its own website. Neither does it publish the statistical information online.

### **2.4 Comparison with western agencies and western-dominated institutions**

One cannot help observing some striking similarities between Arab and western aid and development finance institutions. The national aid agencies, the AFESD, BADEA and the OFID are the counterpart to the western national agencies and multilateral organizations such as the World Bank and the European Bank for Reconstruction and Development (EBRD). The counterpart to the International Monetary Fund (IMF) is the Arab Monetary Fund (AMF), albeit on a much smaller scale of course. In many respects the IDB is organized along the lines of the World Bank. The IDB has its own currency, called the Islamic Dinar, but it is nothing else but the IMF's Special Drawing Rights (SDR) in disguise as one Islamic Dinar is equivalent in value to one SDR. Like the World Bank Group, there is an Islamic Development Bank Group. One of the Group's members is the Corporation for the Development of the Private Sector, established in 1999, which is the counterpart to the World Bank's International Finance Corporation. The IDB also has a young professionals programme similar to the World Bank. The Arab donors even have a Coordination Secretariat, which is roughly comparable to the OECD's DAC even though the DAC is more important as a coordinating forum of national aid agencies and produces much more comprehensive statistical information and policy documents.

As is the case with western donors, a certain amount of overlap and duplication in Arab development finance is also clearly observable. This stems from the multiple functions Arab donors fulfil. As Arab countries they want to give special attention to other Arab countries and as Muslim countries to other Muslim countries; hence, for example, the existence of separate trade financing programmes for fostering inter-Arab and inter-Muslim trade. Or take the special relations with African countries as another example: Arab donors give aid to African countries via the BADEA, but as OPEC members also via the OFID and, if the recipient country is predominantly Muslim, via the IDB as well.



### **3 The characteristics of Arab aid: a comparative analysis with OECD-DAC aid**

#### **3.1 Motives for aid giving and allocation**

The motives for Arab aid giving and allocation have been controversially discussed in the literature. Scholars from western countries have often been critical, whereas representatives from the Arab world have been more positive in their assessment, insisting that Arab aid is less motivated by donor interest and more beneficial to developing countries than western aid. Representative of the western critical view is, for example, Hunter (1984: 58) who states that ‘the aid policies of the Arab members of OPEC have been motivated first and foremost by their security, politico-ideological and economic objectives’. Representative for the competing Arab view is Shihata (1982: 203f.) who stresses the generosity of Arab aid-giving, its untied status, supposed ‘geographical diversity’ and difference to aid from western donors, which ‘usually confine it to countries that are of obvious economic or political interest’ to them in order to achieve such ‘typical objectives as securing markets for their products or sources of raw materials, preserving former influence, attempting to acquire new influence, or at least ensuring the neutrality of the aid recipient’.

What are possible motives for Arab countries to give aid and to allocate the aid flows the way they are allocated? To start, Arab countries have always been and still are the main beneficiaries of such aid. Indeed, in the very early years often only Arab countries were eligible for Arab aid. For example, only Arab countries were eligible for the receipt of aid from the Kuwait and the Abu Dhabi Fund until 1974. Still today the AFESD gives aid exclusively to Arab countries. Arab countries like to portray this as a living example of active Arab solidarity of the donor countries with their poorer cousins (Achilli and Khaldi 1984). More critical voices see it as the attempt to buy off a threat by more populous, envious and greedy neighbours in inducing them to believe that friendly relations are more rewarding than hostility would be (Hunter 1984). However, generally speaking, eligibility and the range of recipient countries widened substantially after the very early periods of Arab aid allocation.

In addition to Arab countries, many observers also suggest that Sub-Saharan African countries are favoured due to the pursuit of Afro-Arab unity and the traditionally strong links between these countries and Arab countries (Simmons 1981: 16). Many Arab countries are located in Africa, have shared a history of colonization with African countries and have generally supported nationalist liberation movements against the colonization powers. Again, a potential pro-African preference is suggested by the existence of such organizations as BADEA.

Besides Arab and African solidarity, another potential preference suggested by, for example, Mertz and Mertz (1983) and Hunter (1984) is with respect to Islamic countries. Khaldi (1984: 13) rejects the suggestion that Islamic countries might be favoured by Arab aid in claiming that ‘Arab aid does not have any religious character’. However, suggestive of such potential preference is the existence of such multilateral agencies as the IDB. A middle position is taken by Porter (1986: 63) who believes that the ‘Islamic connection’, whilst existent, ‘appears to be of relatively small significance among the motivations underlying the Arab aid effort and its distribution’.

Turning towards more directly political factors potentially influencing Arab aid allocation, Mertz and Mertz (1983: 21) claim that ‘political interests dictate the

distribution of Arab aid' such that aid allocation might be biased towards countries that are similar in their foreign political positions, in particular with respect to issues concerning the Israel-Arab conflict (similarly, Simmons [1981]). An example of such a position is a statement by its Foreign Minister in 1985 that Kuwait will not give any aid to countries that establish or re-establish diplomatic relations with Israel (Nonneman 1988: 152). However, the claim that political interests heavily influence the distribution of Arab aid is again rejected by Al-Ani (1984: 42) who states that many of the recipient countries do not have diplomatic relations with OPEC (and therefore Arab) donor countries.

Finally, Arab donors, like many other aid donors, suggest that they take the need of potential recipient countries into account in favouring poorer countries. For example, Al-Humaidi (1984: 60) states that it has been the general policy of the Kuwait Fund to favour 'those countries of the developing world which are more in need of assistance than others'. Similarly, Humaidan (1984: 69) claims that the Saudi Fund for Development 'has tried to focus the benefits of its assistance predominantly on the poorest countries, those having very low per capita income'. The website of the OFID assures its visitors that whilst all developing countries are in principle eligible for Fund assistance 'the least developed countries (...) are accorded higher priority' (OFID 2002).

### **3.2 Absolute volume**

Table 1 provides an overview of the development of Arab country and multilateral agency aid in the form of net ODA disbursements and net other official flows (OOF) in comparison to the analogous stream of finance provided by OECD-DAC countries over the period 1974 to 2000. OOF comprise other flows of finance to recipient countries that do not meet the conditions of ODA 'either because they are not primarily aimed at development, or because they have a grant element of less than 25 per cent' (OECD 2002b: 294).

Note that no data for individual countries or agencies are available after 1989.<sup>3</sup> Also, these data stem from OECD estimates. As Iqbal (1983: 31) notes, OECD estimates have tended 'to diverge from indications provided by certain national authorities. These divergences can largely be attributed to differences in the definition of assistance and coverage, and have probably led to underestimates in the DAC figures'. Some donors, particularly Saudi Arabia, also keep a part of their aid giving secret (Nonneman 1988; Van den Boogaerde 1991).

A number of conclusions can be drawn from the information contained in Table 1. First, the total amount of aid given is substantial. The vast majority of this aid stems from only four countries (in order of importance): Saudi Arabia, Kuwait, United Arab Emirates. Smaller amounts come from Algeria, Libya, Qatar and in past years from Iraq as well. Second, the amount of OOF is small compared to ODA and becomes negligible or even negative in the 1990s. This suggests that ODA is the greatly dominating part of development finance provided by Arab donors. Third, the amount of aid given is volatile and changes quite substantially from period to period. There is much more

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<sup>3</sup> The data from individual countries and agencies do not always add up to the aggregate country and agency figures due to inconsistencies and inaccuracies in estimation.

volatility in Arab aid than there is in aid given by OECD-DAC countries. Fourth, there is a substantial fall in the amount of Arab aid given in the second half of the 1980s and the 1990s. For the Arab agencies the net ODA figures even turn negative between 1995 and 1999, suggesting that more money flew back to the agencies in the form of repayments than were newly given out. Note that part of the sharp downfall in aid in the early 1990s is due to incomplete data: Until 1992, the aggregate Arab country data comprise the combined total for Algeria, Iraq, Kuwait, Libya, Qatar, Saudi Arabia and the United Arab Emirates. From 1993 to 1996 the data cover Kuwait, Saudi Arabia and the UAE only, from 1997 onwards data for the UAE are not included. However, given that Saudi Arabia, Kuwait and the United Arab Emirates are by far the major Arab donors, it is clear that the major explanation for the rather sharp downfall in Arab aid in the 1990s must lie somewhere else. We will come back to this point again further below. As concerns the Arab multilateral agencies, the data comprise the combined total for BADEA, AFEDS, the IDB and the OFID. Fifth, the amount of Arab aid has been quite substantial in the past compared to DAC bilateral aid, reaching around half of DAC aid in the late 1970s. Sixth, if taken over the whole period or looking only at the last 15 years or so, Arab aid is relatively small compared to DAC aid, however. Still,

Table 1  
Net development finance in current million US\$

	1975-95	1980-84	1985-90	1990-94	1995-99
<b>Net official development assistance (ODA)</b>					
Arab countries	5,238.1	5,710.8	2,618.2	2,137.5	464.0
Algeria	76.6	83.4	51.7	na	na
Iraq	263.1	218.3	-17.7	na	na
Libya	158.4	164.9	81.5	na	na
Qatar	199.5	138.9	5.5	na	na
Kuwait	984.8	1,101.1	415.7	na	na
of which: Kuwait Fund	188.9	332.7	139.0	na	na
Saudi Arabia	3,526.0	4,299.5	2,250.5	na	na
of which: Saudi Fund	149.6	255.3	79.5	na	na
UAE	991.8	561.2	41.8	na	na
of which: Abu Dhabi Fund	76.9	53.7	-43.3	na	na
Arab agencies	578.3	305.2	108.3	190.4	-13.2
AFESD	108.2	79.3	122.5	na	na
IDB	108.4	121.2	-22.6	na	na
OFID	111.6	198.6	-13.2	na	na
BADEA	29.6	33.5	13.8	na	na
DAC	10,869.9	17,684.9	28,030.4	41,448.7	37,731.3
Total Arab ODA as % of DAC ODA	54.1	34.47	10.36	5.76	1.22
<b>Net other official flows (OOF)</b>					
Arab countries	794.9	769.6	-163.8	50.5	na
Arab agencies	47.6	41.4	40.3	-11.5	na
DAC	2,387.2	4,456.9	4,217.0	7,595.3	9,336.6
Total Arab OOF as % of DAC OOF	35.30	18.20	na	0.51	na
<b>Net OOF as % of net ODA</b>					
Arab countries	15.18	13.48	na	2.36	
Arab agencies	8.23	13.56	37.21	na	
DAC	21.96	25.20	15.04	18.32	24.74

Note: na: not available or not applicable.

Source: Van den Boogaerde (1991); OECD (2002a).

one needs to put things into perspective. Arab countries are fewer and poorer than their OECD-DAC counterparts. Also, whilst Arab countries are not the only donors of aid other than the western countries organized in the OECD-DAC, they are the only major ones. Other donors such as Iceland, Turkey, the Czech Republic, India, South Korea, China and Taiwan provide only very small amounts and, with the exception of Iceland, are recipients of aid flows themselves.

What are the reasons for the volatility of total Arab aid that was already mentioned? Column I of Table 2 provides estimation results from a simple econometric model with the log of total Arab net ODA over the period 1971 to 1997 as the dependent variable combined oil and natural gas revenue of Kuwait, Saudi Arabia and United Arab Emirates (taken from World Bank 2001), a dummy variable for the years after the Second Gulf War as well as combined oil and natural gas revenue of Kuwait, Saudi Arabia and United Arab Emirates (taken from World Bank 2001), a dummy variable for the years after the Second Gulf War as well as a time trend as the independent variables. Note that the aid and natural resource rents values have been converted into US dollars of 1995 with the help of the IMF's world unit import price index. Standard errors are robust towards arbitrary serial correlation and heteroscedasticity. The estimated elasticity for the oil and natural gas rents is 0.8, which clearly shows the dependence and strong sensitivity of the total amount of aid given towards the total revenue of Arab donors from their natural resource extraction. The Gulf War dummy is also highly significant and negative. This variable captures the effect that Arab countries had to contribute enormous amounts of money for their war and post-war efforts, which reduced their willingness to give aid. Note that the time trend is of importance, but not outstandingly so. The R-squared for our model falls from 0.8 to 0.6 if the dependent variable is detrended as suggested by Wooldridge (2000: 337). This suggests that the volatility of the resource rents and the exogenous shock of the Second Gulf War are the main determinants of the volatility in total Arab aid flows.

Table 2  
The determinants of the total volume of Arab aid

Dependent variable:	I	II
	ln (total Arab net ODA)	ln (Arab net ODA as % of GNI)
ln (oil and gas rents)	0.798 (4.50)**	0.475 (2.44)*
Gulf War dummy	-1.178 (3.36)**	-0.427 (1.36)
ln (GNI per capita)		-0.284 (0.86)
Time trend	-0.040 (2.11)*	-0.078 (4.14)**
Constant	74.218 (1.88)	148.68 (3.95)**
Observations	27	27
R-squared	0.81	0.85
R-squared detrended	0.61	0.31

Note: Robust t statistics in parentheses. \* significant at 5%; \*\* significant at 1%.

### 3.3 Generosity: aid as a percentage of GNI

Arab countries have been rather generous donors in the past if generosity is measured in terms of aid as a percentage of the donors' gross national income (GNI). Indeed, except for very recent years, Arab donors have been more generous and often substantially more generous than western donors. How generous Arab donors exactly are is difficult to say due to two things: First, as mentioned in the last section, the total amount of Arab aid is somewhat difficult to establish with certainty. Second, and more importantly, the GNI of Arab countries is more difficult to estimate accurately than that of western donors as their GNI is heavily dependent on oil and natural gas extraction. Table 3 provides estimates of the net ODA to GNI ratio of Arab donors over the period 1975 to 1999 (GNI data taken from World Bank 2001). Note that again, no data for individual countries are available after 1989.

An important and distinctive feature of Arab aid-giving that has been alluded to already in the last section is its volatility, which not only shows in the absolute amount of aid given, but also in terms of the amount of aid given as a percentage of GNI. What explains this volatility of generosity in Arab aid-giving? Round and Odedokun (2002) show that the donor country's income, the extent of military adventurism as well as characteristics of the donor country's political system determine aid generosity by DAC donors across countries and time. Clearly with Arab aid, military adventurism is not an issue and their political system is rather homogeneous both across donors and time. However, what about income, is it a determinant of aid generosity as is the case for many western donors? Column II of Table 2 presents results for the same model as in the last section, but this time the dependent variable is the net ODA-to-GNI ratio and we add the log of per capita GNI as a further explanatory variable. Per capita income is highly insignificant, but the variable measuring rents from oil and natural gas extraction is still positive and statistically significant. In other words, contrary to western countries, Arab donors' generosity of aid giving depends on the total profits from natural resource extraction, but not on their per capita income levels. The Gulf War dummy no longer is significant. The reason is probably that the Gulf War not only brought total aid volumes down, but also the GNI of Arab donors. The time trend is more significant than was the case when total aid volume was the dependent variable. Over time, Arab donors have become substantially less generous. The importance of the time trend can also be seen in comparing the R-squared of our model with the one of the detrended dependent variable. The R-squared falls from 0.85 to 0.31. This implies an increasing extent of aid fatigue of Arab donors over time.

It is important to note that the figures contained in Table 3 potentially underestimate the generosity of Arab aid-giving, however. This is because the GNI of Arab aid donors mainly derives from the extraction of non-renewable resources and is likely to be inflated. Since such extraction leads to exaggerated income figures given that the partial liquidation of capital (the resource stock) is erroneously counted as true income (Neumayer 1999, 2000), actual GNI is lower and the aid provision to GNI ratio therefore higher than the published figures would suggest (see also Raffer and Singer [1996: 124ff.]). Representatives from Arab donors therefore rightly argue that 'Arab aid represents a greater sacrifice than the aid given by the industrial countries' since their aid is 'deducted from income which is in reality a cash exchange for a depletable natural resource' (Shihata 1982: 202). Another aspect to consider is that whilst western multilateral development agencies can borrow money at very favourable terms from the international capital markets due to their excellent credit rating, this is not really

possible for the Arab agencies. Instead, they depend entirely on contributions from member countries as well as from profits accruing from its lending activities.

Critics of Arab donors have sometimes argued that the huge amount of money given to the so-called front-states bordering on Israel such as Egypt, Jordan, Syria and Lebanon as well as potentially that given to other Arab countries as well should not be counted as aid due to its mainly political rather than developmental motivation (Hunter 1984: 180; Porter 1986; Nonneman 1988). We will see further below that Arab aid indeed is heavily concentrated on Arab recipient countries. However, if one were to follow such an argument, then one would also need to deduct from US aid-giving American aid going to Egypt and Israel, for example, or French aid going to its former colonies. Indeed, studies of aid allocation such as Berthélemy and Tichit (2002) or Neumayer (2003b, 2003c) demonstrate that most donors pursue political, economic and other interests in their aid allocation besides a desire to help poorer countries. Whilst a high concentration of aid in certain recipient countries represents a problem in and of itself, it does not imply that such aid should be deducted from the total amount of aid given. After all, to the recipient country, aid is aid whatever the motives for providing it.

Other critics such as Hunter (1984) have also argued that the seemingly generous Arab aid is still likely to be lower and perhaps much lower than the economic loss to developing countries in the form of higher prices for oil and natural gas as a consequence of OPEC's exercise of market power. Whatever one might think about such an argument, in principle there is nothing that forces Arab countries to share a substantial part of their wealth, which is undoubtedly built on oil and natural gas, with poorer developing countries in the form of aid. Furthermore, with similar reasoning one could question whether western countries provide any net financial resources at all to developing countries given the enormous flows of money going out of developing countries in order to serve their debt obligations.

Table 3  
The generosity of Arab aid-giving compared to DAC aid (in % of GNI)

Period	1975-79	1980-84	1985-89	1990-94	1995-99
Arab countries	3.48	1.85	1.00	0.94	0.24
Algeria	0.28	0.19	0.09	na	na
Iraq	1.20	0.61	-0.04	na	na
Libya	0.96	0.51	0.35	na	na
Qatar	6.47	2.12	0.18	na	na
Kuwait	5.89	3.78	1.58	na	na
Saudi Arabia	7.57	4.63	1.57	na	na
UAE	8.03	1.87	0.07	na	na
DAC countries	0.33	0.36	0.35	0.32	0.24

Note: na: not available.

Source: Van den Boogaerde (1991); OECD (2002b) and earlier similar volumes.

### 3.4 Geographical allocation

In terms of regions, Arab aid has always been mainly given to Arab countries, then to Sub-Saharan African and Asian countries with little aid going to Latin American countries. This is demonstrated in Table 4, which shows the regional allocation of aid in

five-year averages over the period 1980 to 1999. Note that the aid figures refer to commitment rather than net ODA disbursements, as the latter is more volatile and dependent on back flows of money from loans in earlier periods. Arab agencies have shifted emphasis from Sub-Saharan African towards Arab countries over time. In comparison, aid from OECD-DAC countries has gone mainly to Asian and Sub-Saharan African, with less aid going to Arab and more aid going to Latin American countries. There can be little doubt that western aid is more geographically balanced than Arab aid. Table 5 provides similar information averaged over the whole time period, but broken down according to major donor. It is clear that only the OFID is somewhat geographically more balanced and that the Abu Dhabi Fund is most clearly focused on Arab recipient countries, apart from the AFESD of course, which provides aid exclusively to Arab countries.

Looking at the allocation of Arab aid across countries, Neumayer (2003a) finds that poorer, Arab, Islamic and Sub-Saharan African countries are more likely to receive some positive amount of Arab aid (gate-keeping stage). The same is true for countries not maintaining diplomatic relations with Israel as well as those with voting patterns in the United Nations General Assembly similar to Saudi Arabia. Arab and more populous countries also receive a higher share of the total aid allocated (level stage). The same is true for Islamic countries in the case of bilateral aid and countries with voting similarity in the case of multilateral aid. Donor interest, in particular Arab solidarity, therefore plays a clear role at both stages, whereas recipient need as measured by a country's level of income only affects the gate-keeping stage, not the level stage. The result with respect to donor interest is similar to western aid, which is also heavily influenced by the interest of donor countries. However, contrary to Arab donors, western donors also tend to give more aid to poorer countries (Neumayer 2003b, 2003c).

Table 4  
The geographical allocation of aggregate Arab and western aid across regions

Period	1980-84	1985-89	1990-94	1995-99
Arab bilateral country donors				
Arab countries	51.0	44.1	61.7	60.3
Non-Arab Africa	15.5	12.6	8.1	20.5
Latin America	0.7	0.8	2.4	3.0
Asia	11.0	18.4	7.9	8.7
Eastern Europe and Central Asia	0	0	0.35	2.8
Arab multilateral agency donors				
Arab countries	24.5	52.5	73.5	na
Non-Arab Africa	50.6	35.8	19.8	na
Latin America	2.0	1.6	1.6	na
Asia	17.9	9.1	4.4	na
Eastern Europe and Central Asia	0	0	0.46	na
DAC				
Arab countries	16.4	15.2	19.1	10.1
Non-Arab Africa	24.8	26.4	22.2	20.0
Latin America	10.4	11.5	11.0	11.7
Asia	30.0	29.6	27.6	32.7
Eastern Europe and Central Asia	0	0.02	0.53	2.3

Note: na: not available.

Source: OECD (2002a).

Table 5  
The geographical allocation of individual Arab aid across regions

Donor	Kuwait Fund (1962-2000)	Saudi Fund (1975-96)	Abu Dhabi Fund (1971-96)	AFESD (1974-2002)	BADEA (1975-2002)	IDB (1976-96)	OFID (1976-2001)
Arab countries	53.8	45.0	81.6	100	0	54.5	na
Non-Arab Africa	17.3	20.1	7.7	0	100	8.8	49.9*
Latin America	2.2	0.91	0	0	0	0	11.9
Asia	20.9	32.46	10.2	0	0	36.6	37.2*
Eastern Europe and Central Asia	5.8	1.45	0.4	0	0	0.16	0.8

Note: na: not available; \* includes Arab countries.

Sources: Kuwait Fund (2002); Saudi Fund (2002); OFID (2002); Coordination Secretariat (1998).

### 3.5 Allocation across income groups

Another important yardstick for analysing aid flows is to look at the allocation of flows according to income groups, for which Table 6 provides aid commitment data in five-year averages over the period 1980 to 1999. The share of Arab country aid going to least developed countries is roughly comparable to that of DAC countries, but Arab countries give comparatively less to other low income and more to lower middle-income countries than DAC countries. As concerns Arab multilateral agencies, there is a dramatic shift away from least developed countries towards lower middle-income countries. On the whole, western aid is better focused on the poor countries in need of aid than Arab aid is. This is in accordance with the more rigorous econometric analysis summarized in the last section.

Table 6  
The allocation of Arab and western aid across income groups

Period	1980-84	1985-89	1990-94	1995-99
Arab bilateral country donors				
Least developed countries	20.2	16.2	9.4	16.6
Other low income	6.0	3.2	7.2	15.0
Low middle income	42.8	38.0	69.5	47.1
Upper middle income	5.5	1.6	4.9	24.0
Arab multilateral agency donors				
Least developed countries	60.2	50.6	18.9	na
Other low income	15.0	8.0	6.0	na
Low middle income	18.3	34.3	66.4	na
Upper middle income	2.7	2.2	6.8	na
DAC				
Least developed countries	23.8	23.4	17.1	16.9
Other low income	20.3	20.7	19.8	24.9
Low middle income	30.5	28.5	34.8	30.1
Upper middle income	4.0	3.7	4.9	4.2

Note: na: not available.

Source: OECD (2002a).



### **3.6 Dependency of recipient countries from aid**

Given the enormous amounts of aid given to specific Arab countries, particularly those with a common frontier with Israel, one might think that their aid dependency measured as the percentage of GNI derived from foreign aid is much higher than that of major recipients of western aid. It is certainly true that some Arab states derive a substantial part of their GNI from Arab aid. Jordan and Syria, for example, received around 4 per cent of their GNI in 1994 and 1992, respectively, and since the figures taken from Coordination Secretariat (1998) do not contain a substantial part of aid that is never officially made publicly known, the aid dependency is likely to be higher in reality. Note, however, that such dependency of aid is not uncommon among recipients. In 1999, Guinea-Bissau's GNI stemmed to 25 per cent from ODA and Honduras and Nicaragua derived 15.5 per cent and 34 per cent, respectively, of their GNI from mainly western aid (OECD 2002b). There can be no doubt that some Arab recipient countries are dependent from their much richer Arab cousins—in the form of aid, cheap oil imports and, not least, from remittances of workers making a living in these countries. But generally speaking the dependency of these Arab recipient countries is no less than that of many non-Arab developing countries on western aid. Also, the dependency of recipient countries on Arab aid does not imply that they will always or unreservedly follow the will of donors. Egypt, for example, signed its peace treaty with Israel, knowing very well that this would imply that it is cut off from Arab aid and Syria has never withdrawn from its pro-Soviet (now pro-Russian) and anti-American positions in spite of receiving aid from anti-Soviet/Russian and pro-American Arab donors.<sup>4</sup>

### **3.7 Financial terms of aid**

The degree of concessionality is an important aspect of aid for recipient countries. Grants are better than loans and loans with high concessionality are better than those with low concessionality. A frequent critique of Arab aid has been that aid to Arab countries has generally been given in the form of grants, whereas the majority of developing countries, including the least developed ones, are given loans that sometimes have low concessionality (Hunter 1984; McKinnon 1997). Western donors, on the other hand, provide the vast majority of their aid in the form of grants. In particular, practically all western aid going to least developed countries is in the form of grants (OECD 2002b).

### **3.8 Export promotion and tying status**

A common critique of aid by western donors is that they use their aid in part at least to promote their own export interests. This is done in two ways: First, more aid goes to countries, which are the major importers of the donor country's goods and services. Neumayer (2003b, 2003c) finds strong evidence that this is true for most western donors. In contrast, Neumayer (2003a, 2003c) does not find evidence that this is the case for Arab aid allocation, even though there have of course always been calls to make Arab aid work more in the Arab economic and export interests (see, for example, Khader [1984]). Also, things are slowly changing as Arab donors develop a domestic industrial base. For example, the Saudi Fund has recently changed its Charter in order to

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<sup>4</sup> Of course, Egypt knew equally well that American aid would immediately substitute for Arab aid lost due its peace treaty with Israel.

allow for the financing and guarantee of non-oil exports alongside the financing of development projects (Saudi Fund 2002). BADEA issued a board of governors decision in 1997, allowing it to ‘intervene in financing Arab African trade’ (BADEA 2002). The IDB has a trade finance and promotion department and established the Islamic Corporation for the Insurance of Investment and Export Credits (IDB 2002).

Second, sometimes the aid given by western donors is tied towards procurement of goods and services from the donor country. Western donors differ somewhat from each other, but most countries tie at least some part of their aid giving (OECD 2002b). Tying aid usually makes the aid given less valuable as the recipient country cannot buy the goods and services it wants to buy or at least not at the lowest available price. In comparison, Arab aid has practically never been tied, with the exception of relatively unimportant specific loans and grants for oil purchases. This is definitely a positive aspect of Arab aid, which remains positive even if critics are right in arguing that the only reason why Arab aid is untied is because they simply do not produce a wide enough range of goods and services to tie procurement to. However, here as well things are slowly changing. For example, the Kuwait Fund now states in its ‘Procedures for the Procurement of Goods and Works’ that ‘with a view to encouraging the participation of suppliers and contractors from developing countries in the implementation of projects financed by it, the Fund favours that a margin of preference in awarding contracts be accorded to local suppliers and contractors in the recipient country and *also to suppliers and contractors from the State of Kuwait who should be treated on the same basis*’ (Kuwait Fund 2002; emphasis added).

### 3.9 Sectoral distribution

Table 7 provides an overview of the sectoral distribution of Arab agencies. It can be seen that traditional uses such as transport and telecommunications, energy and industry and mining account for the majority for almost all donors. In contrast, with the

Table 7  
Sectoral distribution of Arab aid up to 1996

	Kuwait Fund (1962-2000)	Saudi Fund (1975-2001)	Abu Dhabi Fund (1998)	AFESD (1974-2000)	BADEA (1975-2000)	IDB (1976-97)	OFID (1976-2001)
Transport and telecommunications	34.5	33	92.7	18.5	51.1**	17.9	24.3
Energy	21.3	19	0	28.8	7.1	23.4**	20.7
Water and sewerage	11	18*	3.6	10.4	na	na	7.1
Agriculture and livestock	17	20	0	21.9	29.1	18.7	16.1
Industry and mining	14.7	8	0	10.7	3.2	20.4	2.5
Others (including health, education, training, housing, tourism and balance of payments support)	1.5	na	3.6	9.7	2.1	17.5	20.5

Note: \* Includes education, housing, urban development and health; \*\* includes water and sewerage; na: not available.

Sources: AFESD (2000); BADEA (2002); IDB (1997), Kuwait Fund (2002); Saudi Fund (2002); OFID (2002); and Coordination Secretariat (1998).

exception of the IDB and the OFID, the Arab donors were late in allocating aid to sectors, which are more important to human development than economic development. For example, BADEA did not finance any stand-alone social projects before 1995 (BADEA 2000: 16). A comparison with western donors is somewhat difficult given that sectoral definitions vary, but OECD (2002b: Table 18) reports that about 30 per cent of OECD-DAC countries' aid in 1999/2000 went into the social and administrative infrastructure and there can be no doubt that western donors have put more emphasis on aspects of human development than Arab donors have so far. Arab donors are slowly giving more priority to such sectors as health, education and empowerment of women now, but still have a long way to go to correct a bias towards more visible, but only seemingly more productive, physical infrastructure projects.

### 3.10 Development aid philosophy

Particularly in the 1970s and early 1980s Arab donors commonly stated that their aid aims to develop a new international economic order and self-reliance among developing countries (Hunter 1984), a philosophy western donors naturally never subscribed to. However, such rhetoric is no longer apparent.

A still existent and remarkable contrast between Arab and western aid giving is that Arab donors by and large have either not followed at all or more commonly have followed only to some extent and after substantial delay the many evolutions—some would say fads—in development aid thinking of western donor agencies. Indicative of this tendency to follow the OECD-DAC crowd with delay is the following paragraph in the 2000 Annual Report of the Arab Bank for Economic Development in Africa:

Through its contribution to sectors the Bank aims at *coping with the changes which development financing has witnessed during the last few years* whereby efforts are focused on projects for poverty reduction, improvement in the standard of living of the weaker segments of the population, food security and environment protection, in addition to those projects that lead to increased contribution by women to development, reduce unemployment and support human development (BADEA 2000: 12; emphasis added).

In particular, Arab donors have never been proactive in advancing the debate on the proper objectives and design of development aid. Whereas the OECD-DAC has produced one document after the other on how aid should be designed in order to promote poverty alleviation, sustainable development, environmental protection, gender equality, violent conflict prevention, local ownership, effective partnership with recipient countries, good governance, etc. no similar engagement with such topics can be discerned from Arab donors.<sup>5</sup> It is not quite clear why Arab donors have been insulated from such developments in the development aid philosophy. They do not face an active community of non-governmental organizations and are not challenged by a critical public, of course, which might partly explain why there appears to be little open

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<sup>5</sup> The one, but rather limited exception is the Kuwait Fund, which has always assumed a bit the role of a pioneer amongst Arab donors. It stresses that the promotion of sustainable development is one of its key aims and that it has insisted on the inclusion of an environmental study in each project report from as early as the mid-1980s onwards (McKinnon 1997).

discussion on what aid should achieve in recipient countries and how aid can be designed better to meet these objectives.

#### **4 Recommendations for the future**

From our review and analysis of the institutions of Arab development finance, its characteristics and trends, a range of recommendations to path the way forward can be drawn. First, Arab donors should reverse the recent downfall in aid flows and, more importantly, should strive for a more steady and less volatile flow of aid. They are not poor by any means and a steady and high flow of aid to poorer developing countries will help them improve their reputation in the world, which is always under threat due to the fact that they are amongst the very few high income developing countries. Connected to this, Arab donors should set themselves a target of aid as a percentage of GNI. The United Nations recommended target of 0.7 per cent of GNI could serve as a minimum target. This will help to steady the flow of aid.

Second, there is no need to balance out the regional allocation of Arab aid. The bias towards Arab countries is natural and the bias towards Sub-Saharan Africa not unwelcome given the poverty of these countries. The bias against Latin America does not matter much given the generally higher living standards in these countries and given that western donors provide substantial amounts of aid to Latin America. There is, however, a need to reconsider the allocation of Arab aid across income groups. Arab aid should become better targeted towards the poor and very poor recipient countries. Connected to this, Arab aid should raise the grant share and raise the concessionality of loans to the poor and very poor recipient countries.

Third, Arab donors should refrain from following the bad example of western donors to use aid for the promotion of the donor country's exports. Finance and institutions for trade promotion should be kept strictly outside the finance and the institutions responsible for aid giving. Fourth, Arab donors should re-allocate more resources towards the 'soft' social sectors of human development and away from the 'hard' physical infrastructure sectors. Fifth, Arab donors should re-consider the structure of Arab development finance, which produces some amount of overlap and sometimes duplication amongst some of the multilateral agencies. A merging of agencies is probably unrealistic, but it is not clear, for example, why the OFID needs to provide development finance for Arab and African countries as well when there exist specialized institutions for both groups of countries. Of course, Arab donors are not alone in this respect. If anything, the complexity and overlap of western agencies are even greater. However, there is also no need for Arab donors to repeat the mistakes of western donors.

Sixth, the Coordination Secretariat should be strengthened. Its role should become enhanced. It should provide more frequent, more comprehensive and more easily available statistics on Arab aid-giving and should represent and promote Arab aid to the outside world. This might imply better staffing of the Secretariat. It should become a forum in which Arab donors can actively participate in discussions and debates about the proper objectives and design of development finance. The OECD's DAC can function as a role model even though not all the functions of the DAC need to be taken over by the Coordination Secretariat. Arab donors should more actively participate in

the discussion of issues surrounding the development aid philosophy. Such a discussion should be fostered both amongst Arab donors and in constructive exchange with western donors. As a logical consequence, the main Arab donors should seek closer cooperation with the DAC in the long run. Joining the DAC is not an option as Arab donors cannot become OECD members given the differences in the political and economic systems between them and the OECD countries. However, there is nothing inherent in aid giving by Arab donors that makes them incompatible with western donors and would stand against closer cooperation. The current lack of such cooperation seems to be due to a combination of western countries not taking Arab donors seriously as partners of development finance—an impression fostered by the recent fall in the volume of Arab aid-giving—and Arab unwillingness to succumb to the rules of transparency, peer review and open debate that characterizes the OECD's DAC.

Following these policy recommendations would help Arab donors to provide more reliable, better targeted and more effective aid for the twenty-first century. Arab aid once was an important and highly regarded source of development finance for poorer developing countries. Arab donors should strive to regain this regard and to do even better than before.

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