Alonso, José Antonio. "From Aid to Global Development Policy." *Alternative Development Strategies for the Post-2015 Era*. Ed. José Antonio Alonso, Giovanni Andrea Cornia and Rob Vos. London: Bloomsbury Academic, 2014. 287–320. *Bloomsbury Collections*. Web. 26 Apr. 2023. <<http://dx.doi.org/10.5040/9781472593047.ch-010>>.

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Chapter 10

From aid to global development policy

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10.1 INTRODUCTION

Over the last decade, the international community has taken visible steps forward in reforming the international cooperation system. This includes a greater focus on aid ownership by recipient countries and renewed commitment to the coordination, harmonization and alignment of donor policies. The 2005 Paris Declaration, the subsequent Accra Agenda for Action in 2008 and the Busan Partnership for Effective Development Cooperation in 2011 are agreements that imply a certain rebalancing of the relationships between partners and donors. Nevertheless, recent external evaluations of this process show that the advances have been smaller than initially committed to by donors (OECD, 2011a).

These changes in development policy were accompanied by devoting a greater focus to targeting resources to the poorest countries. As a result, low-income countries (LICs) and, particularly, nations in Sub-Saharan Africa have become more significant aid recipients, while middle-income countries (MICs) have seen their share reduced in the allocation of official development aid (ODA). There has also been a change in the sectors targeted by aid, with more resources going to social sectors (like education and health), at the expense of those oriented to the economic structure of recipient countries.

During the last decade, aid resources were also significantly increased, reaching their historical highest level in 2010. Even so, the volume of aid fell below donors' previous commitments. In any case, the current crisis has begun to affect ODA, which reduced its volume in 2011. Doubts about the future trend of aid demand that new financial mechanisms be employed to combat poverty and to face new global issues. These new financial sources should be more dynamic and less discretionary than ODA.

Despite the changes promoted within the aid system, there is a feeling that development policy is not up to the challenges of today's reality. Although the international aid system has changed, the international reality has changed more profoundly and more rapidly. A list of the most relevant changes in the international arena comprises the growing heterogeneity of the developing world; the new geography of global poverty; the emergence of new regional and global powers from the developing world; the presence of new development aid players; and, finally, the enlargement of the sphere of international public goods. Implementing the right response to the challenges arising from these changes will demand deeper reform of the aid system.

The debate over such reform comes at a time when there seems to be a renewed scepticism about the effectiveness of international aid. Fuelling that scepticism are meticulous research papers (Rajan and Subramanian, 2008, for example) as well as essays, varying in approach and quality but with high media impact (Moyo, 2009, for example). However, this scepticism about aid effectiveness does not always seem well founded, both in macro-level estimations and in micro-level impact evaluations (Riddell, 2007).

This chapter aims to contribute some reflections and evidence on these matters, in light of the post-2015 agenda. The chapter is structured around five sections, in addition to this introduction. The second section analyses the evolution of aid in relation to the crisis; the third section is aimed at reviewing the conclusions of the specialized literature on the overall effectiveness of aid; the fourth section discusses the relationship between the agenda for the reform and the studies on aid effectiveness; the fifth section compares the reforms of the development aid system with the changes experienced in the international system; and in the final section, by way of a conclusion, three foreseeable scenarios for the aid system are presented.

10.2 AID AND DEVELOPMENT FINANCE

Aid: resistance to growth

In the course of its history, growth in development aid has been rather limited: between 1960 and 2011, the volume of ODA¹ (at constant prices) tripled despite the fact that, during this same period, the number of donor members on the Development Assistance Committee (DAC, OECD) increased from 8 to 24 and the level of GNI per capita for this group of countries quadrupled (figure 10.1).

The gentle growth in total sums of aid has been accompanied with a falling trend in the ratio of ODA as a percentage of the GNI of the donors. For the past two decades, that coefficient has remained below 0.33 per cent (0.31 per cent in 2011). Therefore, despite the repeated commitments of donors, at the beginning of the second decade of this century, only five countries were meeting the agreed-upon goal (0.7 per cent), and the average ratio was below half that coefficient (0.31 per cent).

Figure 10.1
Trends in ODA, 1960-2010

Source: DAC (OECD), DAC Statistical Tables.

When both variables—ODA and the OECD GNI—are considered, the dynamism of the former is not higher than the latter's, a necessary condition to increase the ratio ODA over GNI (figure 10.2). Moreover, the connection between the growth rates of the OECD GNI and ODA is very limited, showing that donors' economic situation is only a minor factor in explaining aid disbursements (figure 10.3).

Figure 10.2
Trends in ODA and GNI of OECD at constant prices, 1970-2010

Sources: DAC (OECD), DAC Statistical Tables, and World Bank, World Development Indicators.

Figure 10.3
Annual rates of growth of GNI of OECD and ODA at constant prices, 1970-2010

Sources: DAC (OECD), DAC Statistical Tables, and World Bank, World Development Indicators.

Finally, neither does there seem to be an expansive trend in aid in relation to the respective GNI of recipient countries. When the developing world as a whole is considered, the ratio of aid to the GNI of recipient countries has followed a slightly decreasing trend, although with variations, depending on the period (figure 10.4). When the group is divided up into three income levels, considering also the United Nations Least Developed Countries group (LDCs), only those in the LICs and LDCs groups demonstrate an increasing (although variable) tendency in their ratios (figure 10.5).

Figure 10.4

ODA as a share of recipient country GNI (low and middle-income countries), 1960-2010

Source: World Bank, World Development Indicators.

Figure 10.5

ODA as a share of recipient country GNI by level of income, 1960-2010

Source: World Bank, World Development Indicators.

In short, over the years, aid has proven to have very limited elasticity to growth, even in periods of prosperity in the donor countries. This is a trait that should be taken into account in order to set realistic commitments for the future.

Public and private funds

The limited dynamism of aid is in contrast to the unprecedented expansion in private financial flows to developing countries in the last two decades (figure 10.6). In that period, the rate of growth in aid is lower than that of the remittances of migrants, direct investments, or other private flows. As a consequence, there has been a notable shift in the structure of international financing of developing countries, with private funding gaining in importance at the expense of public funding. In this context, it is not surprising that some sectors have questioned the importance of aid in the future development agenda. It would seem as if development aid were condemned to become increasingly irrelevant in a world of globalized financial markets.

Such a conclusion, however, may well be incomplete, for at least three reasons. First, the overall picture presents a version of composition fallacy: the data as a whole masks varying individual behaviour among the different groups of countries. The contribution of aid to total international financial

Figure 10.6
Financial flows to developing countries, 1990-2010

Source: World Bank, World Development Indicators.

flows is clearly irrelevant in the case of the upper-middle-income countries (UMICs), more significant in the case of the lower-middle income countries (LMICs), and by far the greatest source of international funding in the case of the LICs and the LDCs. In fact, in the LDCs, the volume of aid in the most recent five-year period was higher than all other sources of international financing put together (figure 10.7).

Second, the relevance of the funding sources should not only be considered in terms of volume, but also in terms of predictability. In this aspect, aid remains clearly more predictable than private flows. Lastly, for many countries, the most important aspect of aid is not so much the volume of resources it represents, but its effects as an incentive to promote changes or as a means for leveraging additional resources in the market. In sum, aid should be considered mainly as a catalytic means (not a central one) to promote development (Kharas and others, 2011).

Current crisis: the need for new financial sources

From 1997 through 2010, international aid maintained a positive trend of growth, with minor setbacks. Nevertheless, in 2011 aid fell 2.7 per cent in

Figure 10.7
Financial flows to developing countries by income groups, 2006-2010

Source: World Bank, World Development Indicators.

real terms as a consequence of the current crisis, and forecasts point to new decreases in future years. The tendency is clear: in 2010, eight of the 24 DAC members reduced their aid, with that number climbing to 16 in 2011. Given the severity of the crisis and of the fiscal adjustments in donor countries, there is justified concern about the future evolution of aid.

Evidence of the effects of previous economic crises on aid flows is, however, not conclusive. The crises in early 1990s led to disparate results in terms of effects on aid, with significant reduction in some cases (for example, Japan or Finland), null effect in others (Norway or Sweden), and even a slight increase elsewhere (France). Econometric analysis does not shed much more light. The statistical association between expenditure on aid and donors' economic cycles is either weak (Dang and others, 2009) or non-existent (Pallage and Robe, 2001; Round and Odedokun, 2004). Similar results can be found in the relation between aid resources and the donors' output gap, with some authors finding a positive sign (Bertoli and others, 2008) while others are unable to identify any relationship (Faini, 2006). There is perhaps a slightly higher level of consensus around the link between fiscal balance and aid: fiscal surplus (deficit) in a donor country tends to have a positive (negative) effect on aid (Faini, 2006; Bertoli and others, 2008; Allen and Giovannetti, 2009).

This last result supports pessimism about the evolution of aid in coming years. With continuing tight budgets in OECD countries, it will be very difficult for donors to meet their commitments in terms of aid. This is why several sectors have proposed the need to open the cooperation system to new sources of financing that are subject to a lower degree of discretionary decisions by donor governments.

A new, strong argument has recently emerged in support of the same idea: the need for new resources to finance international public goods. Some of those goods are intimately related to the development agenda but would be difficult to finance through ODA. According to the OECD, \$320 billion per year is needed to pay for mitigation of and adaptation to climate change, on top of the \$130 billion in development aid; and climate change is only one of the international public goods under consideration, although doubtless the most challenging.

Proposals in this field are very diverse. Many fall under the category of "innovative financing sources" (even though some of them are very old) (table 10.1). These proposals can be divided into six groups: i) proposals aimed at gathering together resources (both public and private) to focus on a global priority; ii) proposals to allow an anticipated use of resources through

the securitization of future aid funds; iii) initiatives aimed at encouraging voluntary private contribution in tasks of social or environmental interest; iv) proposals aimed at encouraging a better use of private resources that have a potential development effect; v) new mechanisms aimed at strengthening the capacity to leverage new resources for aid; and vi) new taxes on negative international externalities.² Some of these instruments are already in use (the International Financial Facility for Immunization, IFFi, or taxes on airline tickets); others have been used nationally, without international agreements (carbon emissions taxes, for example); and still others are being debated at the moment (a tax on financial transactions, for example).

The search for alternative financing sources should be guided by some normative criteria. Six criteria seem particularly relevant:

- *Additionality*: the resources should be (at least partly) additional to ODA.

Table 10.1
Innovative Finance for Development Mechanisms

	Characteristics	Examples
Traditional	Public resources	ODA from developed and emerging sovereign donors
	Private resources	Private contributions to development cooperation system
Innovative	New Institutions for frontloading resources	International Financial Facility for Immunization (IFFi) Advance Market Commitments
	New ways to put together public and private funds for specific goals	Global Fund/GAVI
	New mechanisms for voluntar contribution	Global or national lotteries/ DigitalSolidaritySocialFund/ REED
	New incentives for a better use of private resources	Corporate Social Responsibility/ Support to some uses of remittances/ Clean Development Mechanisms/ Carbon Funds
	New ways of leverage	Public-private partnership in infrastructure investment/ Development Finance Institutions
	New levies	Airlines ticket taxes/ Tobin tax/ Financial transactions tax/ Carbon emission tax

- *Sufficiency*: the instruments proposed should mobilize sufficient resources in relation to the size of the tasks they need to tackle.
- *Efficiency*: the instruments proposed should generate the lowest possible costs without penalizing economic growth.
- *Effectiveness*: the instruments proposed should be easy to implement.
- *Fairness*: the new initiatives should favour a more equal distribution of resources.
- *Predictability*: the resources of the new funding sources should be easy to predict, to avoid instability.

When all these criteria are considered, the mechanism that has emerged as a possible answer is the tax on international financial transactions. As well as being discussed in the European Union, such a tax has been studied by the Leading Group on Innovative Finance for Development. This group commissioned a technical document that suggests the application of a tax on financial transactions in foreign currencies, destined to finance development aid.³ Even a very low tax rate of 0.005 per cent could raise between \$30 and \$50 billion, and the revenue raised could be increased if other types of financial transactions were also subject to the tax. In any case, this is only one of the options: other proposals (carbon emissions, for example) are also technically viable.

10.3 AID EFFECTIVENESS

Aid effectiveness: a blurred literature

Beyond aid volume, it is also necessary to consider the effectiveness of aid. However, the specialized literature on this subject shows ambiguous and disparate results. Although carried out in a relatively similar theoretical framework, the studies vary in relation to the control variables used in convergence equations, in their handling of the endogenous nature of aid, and in the assumption of non-linearity of aid.

In terms of this last element, some authors suppose that the impact of aid is conditioned by certain recipient countries' characteristics. The influential works of Burnside and Dollar (2000 and 2004) stand out in this approach. These authors show that aid effectiveness depends on the institutional framework and policies put into place by the recipient. As a consequence, the authors advocate a greater role for selective aid allocation, giving aid only

to countries with good policies and institutions (World Bank, 1998). Other authors follow the same approach but incorporate another variable related to the recipient country's circumstances. Among the factors considered have been an export price shock (Collier and Dehn, 2001), the degree of vulnerability (Guillaumont and Chauvet, 2001), previous conditions of violence in the country (Collier and Hoeffler, 2004), political instability (Chauvet and Guillaumont, 2004), the level of democracy (Svensson, 1999), or the limited size of the government (Economides and others, 2008). In all these papers, the effectiveness of aid is confirmed, although the results are highly sensitive to the methodologies used in the respective estimations (Roodman, 2007 a and b and Easterly and others, 2004).

Another evidence of non-linearity is the presence of diminishing returns. In all cases where an appropriate variable was incorporated, the estimation confirms the existence of decreasing marginal returns on aid (Hadjimichael and others, 1995; Durberry and others, 1998; Hansen and Tarp, 2001; or Rajan and Subramanian, 2008). Although it is debatable where the threshold lies, it seems that after a certain level, the accumulation of aid can end up having negative effects on the recipient country. Many of the studies incorporate the existence of decreasing marginal returns, stating that aid is effective in itself, without conditioning by the recipient's policies.

This new generation of studies has also opened up some new issues worth considering. For example, Lensink and Morrissey (2000) showed that instability of aid flow impacts negatively on aid effectiveness. In this study, aid effectiveness is related less to the characteristics of the recipient than to the donor's ways of operating.

Some categories of aid (like humanitarian aid) have no relationship at all to the recipient's growth, while others (like health or education expenditure) only produce effects in the very long-term. For that reason, Clemens and others (2004) refine aid flow, leaving only those elements that have an effect on growth within a relatively short time-scale. After such aid segregation, the results point to a positive robust relation between aid and recipient growth.

Some authors admit that aid can be effective in some places but not in others. For example, Dalgaard and others (2004) confirm that aid is not effective around the tropics, but that it has a positive effect on growth in non-tropical countries. Unfortunately, as Roodman (2007b) highlights, these results are highly dependent on the behaviour of a limited number of countries. In the same vein, Herzer and Morrissey (2009) confirm that aid can have a negative effect on growth in some countries, although the variables that explain such results are not totally intuitive.

Among the most sceptical studies, and also among the most influential, are those by Rajan and Subramanian (2005 and 2008). These authors cannot find any robust relationship whatsoever between aid and growth. The explanation of this result rests on: i) the deterioration of the quality of governance that aid can produce in a recipient country; and ii) the negative effect that aid has on the recipient country's competitiveness, which refers to the problem known as Dutch disease.

Besides these studies, others have tried to conduct meta-studies in order to evaluate the literature already carried out. The first is an article by Doucouliagos and Paldam (2008), who review over a hundred studies. The results they reach are as follow: (i) first, aid has a small negative effect on savings and an equally small, but insignificant, negative effect on investment; (ii) the effect of aid on growth is positive, but not significant; and (iii) the effects associated with conditional estimates cannot be replicated. The authors admit the pessimistic tone of their conclusions.

The second study reveals a more optimist spirit: Arndt and others (2009) carry out an application of the Rubin Causal Model to the most recent publications on the effect of aid. Their results suggest that aid impact on economic growth exceeds its supposed contribution to generating capital stock (estimated by Rajan and Subramanian, 2005), indicating that aid also positively influences the evolution of total productivity. According to the value of the confidence intervals, they cannot rule out the possibility that elasticity falls into the negative zone, but that it is positive wherever the results are the most solid.

Aid, institutions and taxation

One dimension that can explain the disappointing effect of aid is its impact on institutional quality: aid can open space to rent-seeking activities and harm accountability in recipient countries (Moss and others, 2008). The empirical studies on this subject have contributed to consolidating the negative image of aid (Bräutigam, 2000; Knack, 2004; Bräutigam and Knack, 2004; Djankov and others, 2008).

Nevertheless, these studies raise two important elements for criticism: i) they do not specify a convincing model of institutional quality, raising suspicion of omitted variables; and ii) they consider the relationship between aid and the quality of institutions to be linear (although there are many reasons to think that the relationship has diminishing returns).

In a previous estimation, Alonso and Garcimartin (2013) argued that institutional quality can be mainly explained through four variables: the country's level of income per capita, the average years of citizen education, the level of social inequality (with negative sign), and the level of tax resources. In Alonso and Garcimartin (2011a) the authors included aid (measured as a percentage of GDP averaged over five years)⁴ into this explanatory structure. If only ODA is included (in constant dollars or PPP), the coefficient is not significant (although it has a positive sign); however, when squared aid is incorporated (to reflect diminishing returns), both are significant, with aid having a positive sign and squared aid a negative one. In other words, aid has a positive effect on institutional quality, but is subject to diminishing marginal returns, so that from a certain threshold the total impact becomes negative.

Habitually considered among the negative effects of aid is its perverse impact on incentives to set up a solid tax system in the recipient country. But a tax system is crucial to consolidating accountable institutions, and for moving a country from aid dependency to self-sufficiency (Tilly, 1992; Moore, 2009; and Kaldor, 1963).

Previous works that studied the effect of aid on taxes led to notably pessimistic results (Heller, 1975; Cashel-Cordo and Craig, 1990; and Khan and Hoshino, 1992); however, the most recent work has not been so conclusive, and the empirical evidence is ambiguous. Thus although Bräutigam and Knack (2004) find a negative relation between aid and tax effort, other studies are incapable of finding any relationship at all between the variables (Ouattara, 2006; Morrissey and others, 2007; Teera and Hudson, 2004); and the fullest works on this area detect a positive, although weak, relationship (Gupta, 2007; Clist and Morrissey 2011; Brun and others, 2007).

Another study that confirms this last result is Alonso and Garcimartin (2011b). They estimate a structural equation of tax effort in which, alongside the most traditional variables, they include aid and income distribution. Their results suggest that the aid coefficient is significant and positive in all cases, as well as the Gini index, although with negative sign. Given that the impact of aid can be conditioned by the institutional quality of the recipient country (Azam and others, 1999), Alonso and Garcimartin, 2011b) incorporated the product of institutional quality by aid into their previous estimation. The results reveal that both the aid coefficients and those of the interactive term (aid by institutional quality) are significant. This means that aid positively influences tax resources, but its effect is not linear and

depends on the quality of institutions: in a context of bad institutions, the impact of aid on tax collection could be negative.

The overview carried out in the previous two sections is sufficient to confirm that the existing literature on the relationship between aid and growth is far from conclusive. Despite that, the results that could be the most plausible would point out that: (i) the effect of aid seems easier to detect in the short-term than in the long-term (Clemens and others, 2004), although in the long term could also exist a positive effect (Minoiu and Reddy, 2009); (ii) aid seems more effective in contexts where it contributes to relaxing restrictions or factors of vulnerability of recipient countries (Collier and Dehn, 2001; Guillaumont and Chauvet, 2001; Collier and Hoeffler, 2004); (iii) the relationship between aid and growth seems to be subject to diminishing returns (Hadjimichael and others, 1995; Hansen and Tarp, 2001); (iv) there may exist national factors, specific to recipient countries, that condition aid effectiveness, but there is no certainty about what those factors are; and (v) finally, aid can positively influence institutional quality, and there is nothing to suggest that it has necessarily a negative effect on taxes (Gupta, 2007; Brun and others, 2007), but nevertheless, due to its decreasing returns, from a certain threshold, aid effects on both institutional quality and taxation can become negative (Alonso and Garcimartin, 2011b).

10.4 AID EFFECTIVENESS: DONOR RESPONSE

The Paris Agenda: some critical observations

The widespread doubts about aid effectiveness have motivated donors to start a revision of aid management practices. The origins of this process can be tracked back to the document *Shaping the 21st Century*, approved by the DAC in 1996, but the drive for reform gained a renewed boost at the end of that decade as a result of the revision of the HIPC initiative, the debates around the Millennium Declaration, and the dynamic that accompanied the Monterrey Conference on Financing for Development. This reforming spirit was translated into a series of high-level meetings organized by the DAC. At the second, convened in Paris, five central principles were defined in relation to aid effectiveness: (i) recipient ownership of development interventions; (ii) alignment of donor strategies and procedures with strategies and management systems of the recipient countries; (iii) harmonization among donors; (iv) management through results, both for donors and recipients; and (v) mutual accountability. These principles were

revised and expanded at the summits held in Accra in September 2008 and in Busan in December 2011.

The OECD's DAC has undertaken to follow the process through three reports (in 2006, 2008 and 2010). The picture that emerges from the last report is ambiguous: progress has been made, especially in the use of reliable public management systems and in the coordination of technical assistance, but commitments are still far from being met (OECD, 2011a).

In principle, the dynamic that started with the Paris Declaration has to be judged positively. The agreements have been directed at correcting two important problems that penalize aid effectiveness: the existence of perverse incentives stemming from asymmetric information within the aid chain, on one hand, and high transaction costs from the proliferation of donors and fragmented interventions on the other. However, there are two limitations worth highlighting here: (i) the process was mainly led by the donors (through the DAC), even when recipient countries were invited to attend; and (ii) their assumptions are shot through with an excessively technocratic (and rather naïve) vision of social dynamics (Whitfield, 2009).

The first problem refers to the system of principal-agent relations on which aid chain is based, and that condition the incentive framework in which the players act (Gibson and others, 2005; Martens and others, 2002). The fungibility of aid is a manifestation of this problem. Resolving problems of incentive caused by this system of relationships is not simple. In the past, donors sought solution in conditionality, as a sort of implicit contract between donor and recipient. But in a context of imperfect information, it is not plausible to expect an optimal contract design that would exhaustively define in advance all conceivable states of nature. As a consequence, a problem of time-consistency in donors' behaviour is highly probable. Besides that, it is also debatable whether, in such a climate, the donor is in a better position than the recipient to define responses to the development problems that the recipient is facing.

The only possibility for progress on correcting problems of asymmetric information would be through stricter alignment of the goals of both parties in the transaction: and that is precisely the meaning of the principle of *ownership*. In this case, the recipient defines its priorities more clearly, and the donor identifies those areas in which it wants to contribute aid. However, the ways in which these responses have been handled are open to some criticisms. Four are worth highlighting here:

- First, there has been a certain reduction—which could be called technocratic—in the concept of ownership. The reduction has been such

that, frequently, ownership (a process that is eminently political) has tended to be confused with the capacity of a recipient government to define a comprehensive development plan with sets of indicators and solvent systems for monitoring progress.

- Second, an excessively naïve perception of social dynamics has supported the national development strategies. The demand for national consensus as condition for aid support is simply misguided. In societies that are socially fragmented, public action is the result of a confrontation between visions and interests, and of an institutionally channelled political struggle.
- Third, the alignment of the donor with the goals of the recipient has tended to be understood as a merely functional problem of adapting priorities, as if there were a substantial match between the interests of the two parties involved. But that dialogue should be thought of as a strategic game, because there could be also divergence of interests (Whitfield and others, 2008).
- Lastly, the approach was accompanied by highly intrusive formulas of negotiation and aid control by donors. However, as a recent investigation revealed, success can be achieved by much simpler means (World Bank, BMZ and GTZ, 2007).

The other problem of aid that donors have tried to tackle is connected to high costs of transactions of aid. This problem has been increasing as a result of the proliferation of players in the aid system, and the growing fragmentation of their actions (Acharya and others, 2004; IDA, 2007). Donors have tried to address this problem by defining a more active coordination process, and by ensuring a fuller integration of their initiatives into the budgetary procedures of the partner country. The principles of harmonization and alignment are steps toward those goals.

Nevertheless, there have been several limitations in the implementation of these principles. Firstly, the experience shows that donors have been enormously resistant to progress in formulas for directing support budgets. Secondly, despite the fact that some conditions have been eliminated, aid conditionality still remains in many cases. Lastly, limited achievements have been made on complementarity and labour division among the donors.

Aid dependency

Perhaps the most relevant criticism engendered by the Paris Declaration is the absence from consideration of one of the chief problems affecting

aid effectiveness: the dependency that aid generates in many developing countries. However, since one of the results most regularly obtained in studies on aid effectiveness is the fact that aid presents decreasing marginal returns, its impact can turn negative beyond a certain threshold.

Data reveal that levels of dependency are high in a wide range of countries. There are about 40 countries where the proportion of aid is higher than 10 per cent of GDP. Generally, that coefficient is multiplied by a factor of between three and four, to determine the proportion of aid in the public resources. In these cases national institutions are being pushed to direct more attention toward their relationship with international donors than toward the demands or requirements of their citizens.

Resolving this problem does not necessarily mean an unexpected withdrawal of resources of aid. For some recipients, aid resources are a source of financing social policy that is currently difficult to replace. Aid dependency, however, makes it doubtless necessary to: (i) be much more cautious around plans to increase aid, on the understanding that more is not always better; (ii) establish plans to gradually downsize aid in those cases where such a decrease is viable; (iii) pay greater attention to existing routes for mobilizing domestic resources from developing countries, which would involve strengthening tax systems as well as tackling tax evasion and illegal finance flows; and (iv) finally, dedicate more resources to providing international public goods related with development goals.

10.5 CHANGES IN THE INTERNATIONAL SYSTEM: CHALLENGES FOR AID POLICY

As was emphasized at the start, while the aid system has changed, international realities have changed even more rapidly and more profoundly. Among the main changes are the following five.

Heterogeneity in the developing world

International aid was born in the 1950s, confident in a unified diagnosis of the problems characterizing under-development. Now, the heterogeneity of the developing world makes impossible the assumption of a unique diagnosis and therapy for the developing world. In fact, during the last five decades, developing countries followed very different trends. One group—strikingly, the countries located in East and Southeast Asia—have managed

to drive a successful growth process and they have been converging towards the leaders. Another group—the Least Developed Countries—have increased their development distance from leading countries, catching in a kind of poverty trap (Guillaumont, 2009). Finally, a third large group of countries is situated between these extremes, having increased their levels of internal heterogeneity.

In sum, the last fifty years has produced a double divergence, meaning that: (i) the arc of income distribution at a global level opened up, reflecting the growing distance between the extremes; and (ii) the heterogeneity among developing countries increased (Ocampo and Vos, 2008).

Two panels offer a simple way of illustrating this summary graphically: in the first, the increasing relations between the richest and the poorest country and between the richest and the poorest decile of countries (in terms of GDP per capita PPP) are shown (figure 10.8a); in the second, the increasing heterogeneity is measured through the evolution of the coefficient of countries' GDP per capita in PPP over time (figure 10.8b). As a consequence of this double process, it is increasingly difficult to identify the reality of developing countries under a single diagnostic.

The need to respond to this growing heterogeneity constitutes a challenge for the aid system, presented with two extreme options: either to maintain an integral perspective, working through a differentiated agenda in accordance with the heterogeneous conditions of developing countries, or else to transform aid into a focused policy, aiming to specialize in fighting extreme poverty in the poorest countries.

The MDGs seems to point to this last option, demanding aid to be focused on the poorest countries, at the expense of the middle-income countries. Without a doubt, there are reasons to back this trend: as aid resources are scarce, they should focus on the more needful countries. Despite that, there is another, equally reasonable option for maintaining a wider scope to promote developmental incentives in accordance with countries' needs.⁵ Such an approach would involve perpetuating the comprehensive character of development policy, transforming it into a global policy, with differentiated agendas, in keeping with the characteristics of all needful countries, including those MICs with severe vulnerabilities.

Among the arguments that can be offered in support of this second option are the following five (Alonso, 2007): (i) more than 70 per cent of the world's poor population lives in MICs (see next section); (ii) some MICs are highly vulnerable to circumstances in international markets; (iii) MICs are key to the provision of international public goods, particularly environmental

Figure 10.8a

Arch of wealth (GDP per capita) distribution, 1950-2008

Figure 10.8b

Trends in heterogeity in GDP per capita, 1950-2008

Source: Maddison (www.ggdc.net/MADDISON/oriindex.html).

ones; (iv) some MICs have a crucial demographic or economic weighting in their regional environment, so their success can stimulate progress in third countries; and (v) lastly, it is important to build an aid system that is incentive-compatible with the aims of development, avoiding perverse incentives that could result from an abrupt frontier between countries that are the subject of aid.

The new geography of global poverty

With the definition of the MDGs, there emerged a more demanding requirement to focus aid on the poorest countries. As a consequence, in the past decade the proportion of international aid directed to MICs decreased significantly: from about 57 per cent in the 1990s to 37 per cent in 2009/2010. In the other direction, LDCs and LICs increased their quotas from about 43 per cent in the 1990s to 62 per cent in 2009/2010 (table 10.2). So, the purpose of promoting a more poverty-focused type of aid seemed to be on the right track.

Table 10.2
Allocation of ODA by income levels of recipient countries, 1990-2010

Per cent	1990-1993	1998-2000	2006-2008	2009-2010
LDCs	31.8	32.0	35.1	36.6
LICs	10.2	12.5	17.2	16.0
LMICs	49.4	47.1	39.7	28.9
UMICs	8.6	8.5	7.9	8.5

Source: DAC (OECD), DAC Statistical Tables.

The problem is that the new pattern of aid distribution does not match the new geography of global poverty. Analysis of where the poorest populations live shows that most are located in MICs. More precisely, there are as many as a billion poor people—two thirds of the total—living in MICs, with the remaining third (close to 300 million) living in LICs (Sumner, 2010 and 2011). This pattern is entirely new, because in 1990, 94.5 per cent of poor people were living in LICs and only 5.5 per cent in MICs (table 10.3).

This important swing is almost entirely due to the graduation from LIC to MIC status of a significant number of countries, some of them with very large populations (such as China, Indonesia, India, Nigeria, and Pakistan). Although this shift in the geography of poverty might be the result of

changes in a reduced number of countries, it expresses a tendency that will probably maintain over time. Global poverty is not only, nor predominantly, a low-income country issue anymore.

The new geographical pattern of poverty mounts a new challenge for international aid: Should the recommendation to reduce aid to MICs be maintained? Some believe that MICs are rich enough to tackle their own problems, including their national pockets of poverty. But others think that if people (and not just countries) are to matter, there is good reason to combat poverty where the impoverished actually live. However, international support should be graduated in relation to the capacities and resources of each country.

But if aid wants to contribute to reducing poverty in MICs, it should take into account that the poverty in these countries is more a consequence of bad distribution of national income than of a low average income. So, combating poverty will require changes not only in international income distribution, but also in internal income distribution.

Table 10.3
Distribution of global poverty (\$ 1.25 per day) 1990 vs 2007

	Non-adjusted base years				Adjusted base years			
	1990		2007		1990		2007	
	Millions	%	Millions	%	Millions	%	Millions	%
LICs	1,596.1	94.5	305.3	24.1	1,632.5	93.1	342.7	29.1
MICs	93.2	5.5	960.4	75.9	121.4	6.9	836.0	70.9
Total	1,689.3	100	1,265.7	100	1,753.9	100	1,187.7	100
China and India	1,137.9	67.4	673.0	53.2	1,123.6	64.1	561.3	47.6
MICs minus China and India	n.a.	n.a.	287.4	22.7	n.a.	n.a.	274.6	23.3
LICs minus China and India	458.2	27.1	n.a.	n.a.	509.0	29.0	n.a.	n.a.

Source: Sumner (2011).

Multi-polarity

Development aid was born in a bipolar world, characterized by the presence of two blocs in conflict; today, that international reality has disappeared. Instead, a more complex and multipolar world is being consolidated. New international powers from the developing world are being added to traditional powers, and some of these new powers are highly dynamic.

This change also has important implications for the aid system, since some of these emerging powers—along with other developing countries—have become actively involved in sustaining their own development cooperation programs. The exact volume of this South-South aid is not known. Deficient registration systems in the countries involved contribute to the lack of information in this area. In any case, according to the DAC report (DAC, 2011b), the South-South cooperation from 25 non-DAC countries reached as much as \$10.6 billion (8 per cent of total ODA), the most significant contributors being Saudi Arabia (at \$3.4 billion), China (\$2 billion) and Turkey (\$968 million). That said, these estimates do not include all the new donors, suggesting that the total figures must exceed those mentioned.

South-South cooperation incorporates important new elements into the aid system. On the one hand, because this aid is more horizontal, it is easier for the recipient country to control, while its activities also generate a clearer “double dividend”—with benefits for donor and recipient alike. But beyond these factors, most important to note is that South-South aid contributes to spreading a sense of shared responsibility, and not only from traditional donors, in the task of correcting international inequalities.

Apart from its potential, South-South aid poses a challenge to the commitments and structure of the governance of the aid system. Again, this opens up two different options: (i) try to preserve the consensus on which traditional aid policy has been built, seeking to add new donors to this tradition; or (ii) open up debate on new aid practices, in order to define a new consensus that involves the new players without renouncing accumulated aid experience. In the first case, DAC could continue to play its role as a central force in the debate and definition of aid policy; in the second case, however, a more inclusive forum should be sought, in which all involved countries are represented.

International public goods

The globalization process now underway has tended to accentuate interdependencies of all types between countries, increasing indirect effects of a transnational character. As a consequence, the sphere of international public goods (IPGs) has extended from these interdependencies. These goods are characterized by strong externalities, which means that once provided, their benefits are available for everyone in an unlimited way. Such public goods are very diverse in nature and related to the international regulatory order, the sustainability of life, and the possibility for societies to advance (table 10.4).

Table 10.4
Spheres of international public goods

Main objective	Area
Configuration of Social Order	International Justice
	International Norms
	International Institutions
Preservation of Life	Control of Contagious Diseases
	Global Common Goods (Climate Change, Biodiversity, Ozone Layer, International Fisheries)
	Protection from Crime and Drug-Trafficking
	Peace and Security
Wealth Promotion	Financial Stability and Macroeconomic Coordination
	Knowledge Diffusion
	Trade Insertion

The characteristics of public goods dictate that the market is incapable of ensuring their efficient provision, and some form of collective action becomes required. In the international sphere, the response must be carried out through diverse coordination and voluntary cooperation formulas between the players. The multilateral system is the most appropriate framework to promote such cooperative action. However, there is a widely shared view that this multilateral system, in its current form, does not meet the conditions necessary to efficiently promote the IPGs that society demands.

A strong relationship exists between the IPGs and the development agenda. The developmental impact of a new vaccine against malaria (an IPG) can be bigger than that promoted by aid; and the fight against climate change (another IPG) is required for any viable future development. Given their link, two options are conceivable: either to maintain both spheres as separate agendas, or to merge them in a progressive way within a broader global public policy.

There are reasons to try to preserve the demarcations of current aid policy: in the end, the traditional agenda (the eradication of poverty) has yet to be achieved. However, in an interdependent world, it is difficult to achieve effective results in the fight against poverty if action is not simultaneously taken in the sphere of IPGs. This suggests the need for an increasingly integrated perspective for both agendas. Such integration does not necessarily suppose the dissolution of the aid policy into the new

tasks around the provision of IPGs, but rather an effort to identify the inter-linkages between the two agendas. And besides that, it is necessary to complement aid with new financing sources to support the IPGs agenda.

New actors, new instruments

Since the 1990s, the number and diversity of aid providers has increased rapidly. As a consequence of this process, today the global aid architecture is more complex and fragmented than before, with costs in terms of aid effectiveness insofar as the level of coordination among the actors is very low. However, the process has also a positive face: the aid system seems to be more rich and vigorous inasmuch as new actors, with different experience and resources, are implied in the aid policy. In the last decade, three new actors have emerged with special force. First, as we have seen, emerging economies are providing significant resources through South-South cooperation. Second, the private sector, directly or through its foundations, is increasingly supporting international aid programs, besides promoting other activities (“social corporate responsibility”, for example) that, while not being ODA, can have developmental effects. Finally, as a consequence of the partnership between official and private donors, new global funds have emerged in the field of development cooperation. The composition of aid resources shows, albeit in an incomplete way, the more complex structure of the cooperation system, with the new actors (emerging donors and private sources) funding, in 2009, about \$70 billion (near 40 per cent of total aid) (figure 10.9).

With the new actors, the development cooperation system has also increased the range of its available instruments. Most of these new instruments are connected with private sector involvement on development activities. For example, in the last two decades, new financial instruments have been used by donors to promote the private sector in partner countries. Specialized institutions (the Development Finance Institutions, DFIs) are in charge of managing these financial instruments that include equity investment (directly or through investment funds), loans, and guarantees, amounting to nearly 6 per cent of total ODA. In the same vein we could cite the Aid-for-Trade Initiative (AFT), promoted by the WTO to assist developing countries in increasing their exports of goods and services, to better integrate into the multilateral system and to benefit from increased market access.

Figure 10.9
Composition of aid by main channel, 2009

Source: Kharas and others (2009: 5).

The proliferation of actors and instruments has led to a system that lacks coherence. As a consequence, overlap and contradictory efforts are possible, reducing the level of effectiveness of the whole system. The Paris Agenda has tried to curb this problem, calling for donors to achieve more coordination, harmonization, and division of labour. But this approach faces two problems: (i) more and more developmental actors and instruments are operating in a field wider than ODA; and (ii) to be effective, donor specialization and coordination should be locally based, in a way that suits the needs of partner countries.

In relation to this process, the system of development cooperation has two alternatives. On the one hand, donors could again focus their attention within the borders of ODA, in order to reduce the level of complexity of the system. However, the problem is that an increasing number of development activities would then be left out of their focus. Alternatively, donors could accept that the cooperation system has definitively changed: a precise border between aid and non-aid no longer exists (Severino and Ray, 2009). The enlargement of the cooperation system perimeter, with new actors, instruments and goals, demands a move from ODA to a more complex global development policy.

10.6 CONCLUDING COMMENTS

The analysis here carried out confirms that the international development aid system is undergoing a period of irreversible changes. It is impossible to predict whether international aid will be capable of adapting, or whether it will become increasingly irrelevant. Three possible forward-looking scenarios shall be considered here, although in reality there may be some variation or overlap between them:⁶

Scenario 1: Reduction and focus

The first scenario could come about as a result of the progressive loss of drive in the aid reform agenda, and by the relegation of international aid to a minor role in the donors' interests. The severe effects of the economic crisis on many OECD countries could lead to a new phase of "donor fatigue", with a negative effect on aid resources. The limited achievements of the Paris Agenda could lead to revisionist attitudes, aiming to return to more traditional formulas for managing aid. The Paris Agenda might not be abandoned completely, but efforts would be focused on just some of its elements, reducing its degree of complexity. In that case, it is likely that aid would maintain its traditional agenda, without new elements related to providing IPGs. In keeping with the general approach of this scenario, the governance of the aid system would continue to function around the OECD's DAC, with this institution progressively enlarged as long as new OECD members take part, eventually inviting even non-OECD donors or recipient countries to participate in some of their decisions.

Scenario 2: Deepen the path to reform

A second possible scenario is based on the idea that the Paris Agenda was the result of a significant international agreement that is producing results and that, if properly updated, would allow for the aid system to be improved. This process would be compatible with a reduction in rates of growth in aid, and with a search for alternative financial resources. In terms of the aid effectiveness programme, some aspects of the Paris Agenda could be deepened, particularly those which increase the decision-making ability of the recipient country. The purpose would be to build an agenda more focused on countries' specific needs, less general and catch-all in nature. The

monitoring of aid should be less intrusive by the donor in order to favour ownership of projects by recipients. The rest of the Paris Agenda principles would also be maintained, meaning more aid through budget support, reducing conditionalities as much as possible, improving predictability, ensuring that a multilateral approach is favoured, as well as increasing coordination among donors. The goal here would be to work towards results using simpler indicators and incorporating clearer sustainability criteria, reinforcing accountability and the transparency of donors and recipients. New donors would be encouraged to become more actively involved in the new consensus, and they would be encouraged to apply agreed-upon principles to their own practice as donors. This scenario could be developed through peer review processes involving the new donors, carried out in cooperation with the DAC and UNDCF. Support for new (predominantly private) players in the aid system would also be maintained, but keeping the perimeter of ODA well defined. Lastly, environmental sustainability would be incorporated into development aid policy, although aid and IPG provision would be maintained as relatively independent agendas.

Scenario 3: Reconfiguration of the system

The starting point for the third scenario is a more radical assessment of the processes of change that the international system is undergoing. The aim would be to define a new global approach to correct international inequalities and deal with transnational externalities. To tackle that task, it is essential to overcome the traditional separation between donors and recipients on which the aid system is based, creating a framework of shared, although varying, responsibilities, in which industrial countries, but also developing countries with sufficient experience and resources, can take part in the tasks of international cooperation. This scenario would entail a revision of the MDGs as the prime development agenda to promote another, more wide-ranging agenda, based around three large tasks: i) guaranteeing the provision of basic social services to the world population; ii) providing IPGs; and iii) promoting convergence between countries (Severino and Ray, 2009). This new agenda should also include a displacement of concerns from aid to development, while the concern about development transcends the area of financing (and financing goes beyond ODA). Issues associated with the international regulative frameworks (trade, investment and technology, etc.) would also enter into this sphere to ensure a better

distribution of development opportunities, including penalizing those practices which hinder that objective (illicit financial flows, fiscal paradises, etc.). This global approach would have to be compatible with promoting donor support alignment with country-owned and country-led national strategies. In order to make such a policy feasible, it would be necessary to seek an international tax model that could provide complementary financing for development cooperation. As a consequence, a new structure of governance is needed in order to ensure that donor and recipient countries, public and private partners are all represented.

It is clear that the intensity of reform increases as we move through the scenarios from (a) to (c); and the risk of losing valuable aspects of the aid system that should perhaps be conserved also grows. As always, it is important to find a balance between the legacy inherited and the need to meet the changes taking place in society. The first scenario is clearly insufficient to respond to changes already underway, while the third scenario incorporates excessive and ill-defined components. Some point between the second and third scenarios might be the best option for transforming aid into an effective instrument for development in the post-2015 era.

NOTES

- 1 The concept of ODA is defined by the DAC. Even though some components of ODA (such as debt relief or tied credits) are subject to controversy, we will follow the standard classification that the DAC proposes.
- 2 Alternative classifications can be found in Sandor and others (2009) or Girishankar (2009).
- 3 See: http://leadinggroup.org/IMG/pdf/Rapport_TTF_AN.
- 4 Those components that behave more erratically (humanitarian assistance, food aid and debt relief operations) were removed from ODA.
- 5 In fact, such a proposal would supposedly exchange the binomial logic of “graduating” countries for a continuous logic of “gradual support”.
- 6 Evans (2011) offers an alternative vision of future scenarios.

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