



## A PRIMER ON FOREIGN AID

The **purpose** of this paper is to provide an introduction to what is commonly known as foreign aid or official development assistance (ODA), an important part of the relationship between developed and developing countries. In 2015, aid donor countries reported giving US\$132 billion in ODA, an increase of 7% over 2014.<sup>1</sup>

### A. What is aid?

Aid is the main international transfer of resources (principally financial) aimed primarily at development and poverty reduction in developing countries. It covers a range of activities from short-term humanitarian assistance to multi-year, capacity-building programs. The Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD), the group of industrialized, traditional donors of aid, defines ODA as “those flows to countries and territories on the DAC List of ODA Recipients and to multilateral institutions which are provided by official agencies, including state and local governments, or by their executive agencies, and each transaction of which is administered with the economic development and the welfare of developing countries as its main objective, and is concessional in character and conveys a grant element of at least 25%”.<sup>2</sup>

ODA does not include military equipment or services, or anti-terrorism activities. However, the cost of using donors’ armed forces to deliver humanitarian aid is eligible. Similarly, most peacekeeping expenditures are excluded, except for some closely defined,

developmentally relevant activities within peacekeeping. Cultural programs are eligible expenditures if they build the capacity of the recipient country, but not if they serve to promote the donor’s image.

In helping understand the **rationale** for aid, the development thinker Amartya Sen puts it quite clearly: “Development requires the removal of major sources of unfreedom: poverty as well as tyranny, poor economic opportunities as well as systematic social deprivation, neglect of public facilities as well as intolerance or over activity of repressive states”.<sup>3</sup>

The **origins** of current forms of foreign aid lie with the Marshall Plan, initiated by the United States, to help post-WW II Western Europe recover through massive financial transfers to rebuild industrial and civic infrastructure. In the mid-1950s, recognizing the economic and social development needs of the newly independent member countries of the Commonwealth in Asia, the developed Commonwealth members adopted a program of assistance under the title of the Colombo Plan. Canada was a leader of this initiative.

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The wave of African countries achieving independence in the late 1950s and throughout the 1960s presented further demands for aid. Initially, under both the Colombo Plan and subsequent programs of assistance for Africa, the Caribbean and to a certain extent Latin America, emphasis was on infrastructure, following the model of the Marshall Plan. With experience, however, came the realization that this approach was not leading to the expected improvements in quality of life such as increased literacy, longer life expectancy, better nutritional levels and improvement in the situation of women.

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Aid has evolved. In 1968 the Commission on International Development, led by Lester B Pearson of Canada, proposed the ODA to GNP target of 0.7%, which still remains the only agreed quantitative measure of the effort of donors. The 1980s were marked by a number of international commissions and conferences on themes key to development such as gender, environment and education. The 1990s resulted in the United Nations Millennium Declaration and the Millennium Development Goals, including a set of targets to be met by 2015. After the 2002 Monterrey conference on financing for development, especially since 2005, the emphasis has been on aid effectiveness and the partnership between developed and developing countries. While the member countries of the OECD/DAC largely adhere to the various principles, goals and guidelines for good aid, a number of the newer donors from the Global South have kept at arm's length from this framework, preferring to make strictly bilateral arrangements to channel their assistance, which does not always meet the definition of ODA.

## **B. Why is aid important?**

In 2012, almost 400 million of the world's poorest people lived in countries where ODA was the largest single source of international development finance.<sup>4</sup> While foreign direct investment in 2012 in developing countries was approximately four times greater than ODA, almost as much flowed out of these countries as repatriated profits in the same year. While in 2013 the reported level of ODA rose to a record high of \$135 billion, the share going to the poorest or neediest countries in sub-Saharan Africa declined.<sup>5</sup>

Government spending by aid recipient countries plays an essential role in the development process, leading the way in terms of investment in social infrastructure (schools, health systems and water and sanitation facilities), as well as in transportation and energy infrastructure. Domestic resource mobilization is often difficult in poor countries. Aid is important, catalytically and to support infrastructure investment and can multiply the impact of a recipient government's own spending.

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In recent years there have been some widely discussed critiques of aid by William Easterly and Dambisa Moyo among others, arguing that it has not achieved its goals. In fact, Moyo has argued that aid has set back social and economic development in Africa and perpetuated developing countries' dependence on hand-outs. Other critics believe that ODA is no longer important because other financial flows, including remittances and private sector investment, are much greater in volume and better support economic growth and employment generation. However, those flows do not contribute to improving the lives of the poorest people in developing countries by supporting the improvement of education systems, health care

programs and infrastructure (clinics and hospitals), water and sanitation systems, and basic energy and transportation infrastructure in rural areas.

**Remittances** are important for families and for national economies. In 2015, people living outside their countries of birth sent home to developing countries over US\$440 billion. However, unfocused, episodic and skewed, they are not a substitute for development assistance. Almost half of all remittances go to five countries: India (\$72 billion), China (\$64 billion), Philippines (\$30 billion), Mexico (\$26 billion) and Nigeria (\$21 billion).<sup>6</sup> It is worth noting that among the top fifteen recipients of remittances are France, Germany, Belgium, Spain and Italy.<sup>7</sup>

As noted above, **foreign direct investment (FDI)** can be an important source of external finance for developing countries. However, FDI is also episodic and weighted to the extractive sector. FDI to Africa in 2012 totalled US\$56 billion, but was heavily concentrated in a relatively small number of countries.<sup>8</sup> Also, FDI moves both ways – in 2012 FDI outflows from Africa almost tripled to US\$14 billion.<sup>9</sup>

### C. Results of aid

Development is very much a collaborative process, with aid from external sources – if it is done properly – supporting the strategies, plans and programs of the developing countries. Thus it is often difficult to link aid to a specific set of outputs and results, and those who claim their aid has reduced poverty, lowered illiteracy or increased life expectancy are not telling the whole story; the aid receiving country has usually, if not always, been responsible for achieving development goals.

That said, aid has played a very important role in reducing the death rate of children under five years of age, and has supported the success of immunization and disease eradication programs such as those for smallpox, West African river blindness and the progress made in reducing the incidence of polio worldwide. Through these and other health-related and nutrition-linked programs, aid has contributed to increased life expectancy in low-income countries,

from 50 years in 1990 to 61 years in 2014.<sup>10</sup> What is also important is that people in developing countries are less likely to be seriously sick and thus less able to work and support themselves and their families. This reduction in the morbidity rate results in enhanced economic opportunities.

According to the UN, the proportion of people living in extreme poverty fell from 47% of the world's population to 22% between 1990 and 2010.<sup>11</sup> Though it is impossible to quantify exactly how much of this is a result of foreign aid, international cooperation certainly played an important role.

In areas such as democratic development and governance, linking progress to aid-funded interventions is more difficult. There has been an increase in the number of countries with democratic political systems over the last three decades, but how much of that is due to the impact of aid is difficult to assess. Too often, however, public opinion in donor countries is influenced by media reports of instability and conflict in developing countries, for example Mali, Afghanistan, Sudan and Honduras. What is not reported is the political evolution to multi-party democratic systems in Mozambique, Ghana, Senegal, Sierra Leone, Bolivia and even Haiti, though in the latter case democracy is still taking hold and is not assured.

### D. What are the types of aid?

#### Bilateral aid

Bilateral aid is the development assistance provided by donor governments to recipient country governments, often in the form of grants to support sectoral or thematic programs within the development strategies of the recipient partner. Thus donors will allocate funds for education or health programs and projects, transportation, energy, agriculture and environment activities, gender and governance – to name some of the areas seen as key to development. As well as supporting infrastructure bricks-and-mortar, bilateral aid often finances technical assistance or technical cooperation to build recipient country capacity.

Bilateral aid is provided as grants or loans. Initially, bilateral aid tended to be provided as loans which, even on very concessional (soft) terms, led to high levels of indebtedness for many developing countries. Special debt relief programs were organized for least developed and low-income countries in the 1990s and 2000s, which eased the problem. Some donors are now advocating greater use of loans, for middle-income countries with large populations in extreme poverty and even for low-income countries.

Recently efforts have been made to focus on what is referred to as “core” aid, sometimes given the label of Country Programmable Aid, the part of a donor’s program over which partner recipient countries have significant control as it is much more reflective of the true flows going to the recipient. This is the aid that actually is transferred to the developing country, rather than being used to by the donor to buy goods and services offshore which are then delivered to the partner.

### **Multilateral aid**

Multilateral assistance is delivered by a wide range of international organizations supported by member governments. The financial resources given to these organizations count as multilateral ODA if they are pooled (they lose their identity and become part of the institution’s financial assets) and spent at the institution’s discretion.

The best known multilateral institutions are the World Bank and the regional development banks for Latin America, Asia and Africa, as well as UN agencies such as the UNDP, UNICEF, UN Women, WHO, and FAO and WFP. The “universe” of multilateral institutions is very large and the mandates of the organizations vary from very broad to quite subject specific. Some multilateral organizations direct only a portion of their activities to development work, for instance the International Labour Organisation.

In recent years, a new dimension to multilateral aid has emerged in the form of independent funds targeted at an issue or disease, such as the GAVI Alliance, formerly known as the Global Alliance for Vaccination and Immunization, and the Global Fund

to Fight AIDS, Tuberculosis and Malaria. These funds pool donor finance to deliver focussed programs of assistance in partnership with developing countries.

### **Non-governmental aid**

Civil society organizations, or non-governmental organizations (NGOs), raise funds on their own (from individuals, foundations or private entities which does not count as ODA) and also receive ODA funds from donor governments to implement development programs and projects. NGOs are often seen as more effective at working at the grassroots level. NGOs have also played an important role as advocates for more and better aid, and for better development policies and behaviour especially on issues such as gender, human rights and governance. The partners for these NGOs are usually civil society organizations in developing countries. Some NGOs obtain contracts from bilateral donor agencies or international organizations to deliver projects on the former’s behalf, behaving much like a private sector contractor, despite their not-for-profit character. The relations between donor (northern) country NGOs and their partners in recipient (southern) countries have been shifting in recent years as southern NGOs develop greater capacity to plan and deliver programs themselves.

### **Humanitarian aid**

This form of ODA which has the highest profile, due in large part to the media attention it attracts when major emergency assistance is organized in response to a hurricane, an earthquake, a tsunami or floods. It constitutes in most years, however, only 7-10% of ODA spending. Often affecting more people, but less visibly, are the so-called slow-onset humanitarian crisis such as drought-triggered famine. Humanitarian aid is aimed at meeting food, shelter, health, water and sanitation needs of populations affected by emergencies. In conflict related situations humanitarian aid can include efforts to protect vulnerable people from attack by combatants. Despite the media’s tendency to refer to this form of assistance as aid, humanitarian assistance is specifically designed to help recipients survive crises. One of the ongoing challenges for humanitarian specialists is how to manage the transition to recovery and long-term development.

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Depending on the nature of the crisis, humanitarian assistance may actually be provided for considerable periods of time, as is often seen where there are large numbers of refugees as the result of an emergency, or where recovery and reconstruction is slowed or stalled due to conflict. Prominent actors in humanitarian aid include the International Red Cross/Red Crescent Movement, the Office of the UN High Commissioner for Refugees, the UN World Food Programme, UNICEF, and large international NGOs such as CARE, World Vision and Oxfam. When media attention is given to large-scale humanitarian crises affecting many people, a lot of inexperienced organizations and NGOs respond which can challenge coordination efforts and ignore good practice and the established principles of humanity, neutrality, impartiality and independence.

**E. Who provides foreign aid?**

For many years the main **providers** of aid were the market economy developed countries of the Organisation for Economic Co-operation and Development (OECD). Grouped as the Development Assistance Committee (DAC), these countries, Canada among them, have agreed on standards and definitions for what can be counted as ODA. These countries work together to develop good practice guidelines for ODA, peer review each other's programs and report annually on volumes of ODA and the geographic distribution of aid.

Some non-OECD countries use the DAC **definition of aid** as the framework for reporting on their aid. Others label their financial assistance as ODA, even when in fact, if the details of the transactions are known, they do not meet the definition. Donors such as China and India, and to a lesser extent Brazil, tend to make loans to developing countries that while not as rigorous as commercial financing, still lack the concessional

character deemed necessary to be counted as ODA. They often also include trade and investment-related expenditures in their aid figures. Some donors known to be active in certain regions generally choose not to report the amounts and details of their assistance transactions, for example the Arab countries' development funds and banks.

**F. What are the big issues?****Extreme poverty**

A major issue for discussion among aid practitioners and analysts is ending extreme poverty by 2030. Extreme poverty is currently defined as living on an income of less than US\$1.90 per day (see endnote 11). To be sustainable, efforts will have to address adequate nutrition, basic health, education, water and sanitation and housing. In 2010 there were over 400 million people living in extreme poverty in sub-Saharan Africa, and likely more than that in China and India.<sup>12</sup> Getting these people above the daily income level of \$1.90 will still leave them very vulnerable to shocks in the form of storms, floods, droughts and changes in the price of food they buy and the products they sell.

**Aid effectiveness**

For the past decade aid actors have paid a lot of attention to the effectiveness of development cooperation. This is not about the *what* of aid, but the *how* of aid. Beginning at the OECD in 2003, and including the 2005 Paris Declaration on Aid Effectiveness, the 2008 Accra Agenda for Action, the 2011 Busan Global Partnership for Effective Development Cooperation, and the 2014 ministerial meeting in Mexico City, donors and recipient countries have worked on joint measures to ensure that aid flows achieve the maximum impact possible. The main areas of focus are recipient country ownership, alignment with local strategies, harmonization of donor practices, mutual accountability, and attention to development results. Progress, however, has been uneven and below the levels committed to by donors in particular.

Success will mean significant change and improvement in donor behaviour, which seems to be much more difficult to achieve than initially expected in 2005. One of the key issues is greater clarity and timeliness in the publication of data by donors – sometimes referred to as “publish what you fund”. As well, the emerging donors from the developing world are wary of adopting an agenda which they have had little if any role in shaping. Future progress depends on whether the dialogue between the main players, including the aid recipients, continues and offers all participants a sense of responding to their concerns.

### Fragile States

In recent years a number of donors have recognized that fragile states – countries where the government has limited capacity to deliver services to the population and where the rule of law is not consistently or effectively enforced, possibly due to conflict – require special approaches that take into consideration the difficulties of working in these environments. Evidence abounds of the risks resulting from ignoring fragile states (for instance Central African Republic, Democratic Republic of Congo and Somalia) as the problems contributing to their fragility spill over national borders and can result in instability and development setbacks in neighbouring countries. Effective development cooperation in fragile states requires careful coordination and the involvement of all agencies and external players, not an easy outcome to achieve in the absence of one external party willing to provide leadership and accountability.

### Partnerships

Balanced partnerships are essential to successful development cooperation relationships. The history of aid is marked by the unequal nature of the relationship between donor and recipient countries, with the former holding much of the power and control as marked by the lack of transparency and accountability in these relationships. As noted above, the aid effectiveness initiative since 2003, as well as the MDGs and the 2030 Agenda for Sustainable Development, aim to strengthen the partnership dimension of the North-South relationship. Too many donor countries

still approach development cooperation as a charity-based activity rather than a partnership of equals. Successful development assistance is a timely and catalytic contribution to the transformation of recipient country economies and societies.

### G. Beyond foreign aid

Non-aid policies of donor countries can have a major impact on developing countries. Policy coherence for development seeks to ensure that donors’ development cooperation policies and programs are not undermined by other policies and that the latter support development cooperation and the development of recipient countries where feasible. Non-aid policies in such areas as trade, investment, environment, security, migration, agriculture and fisheries can have negative effects on developing countries that completely exceed the value of development cooperation transfers.

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Policy coherence for development is difficult because as it involves trade-offs in the donor country which can generate difficult political costs such as the removal of trade protection measures. In some donor countries, including Canada, the term “whole-of-government” is used to suggest how policy coherence is addressed, but there is not a lot of evidence that this is anything more than policy coordination, an operational exercise at best.

### H. Where do we go from here?

The UN has led the process on the follow-up to the Millennium Development Goals of 2000, known as the 2030 Agenda, incorporating the Sustainable Development Goals (SDGs).<sup>13</sup> A major element of the discussions has been to define the priority target

population, the poorest of the poor. While there are many poor countries in sub-Saharan Africa, the largest number of poorest people live in China and India, which are categorized as middle-income countries. Another area of tension in the SDGs debate is the role to be given to the private sector in development assistance programs.

## NOTES

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<sup>1</sup> OECD, “Development aid rises again in 2015, spending on refugees doubles”, April 13, 2016, [www.oecd.org/dac/development-aid-rises-again-in-2015-spending-on-refugees-doubles.htm](http://www.oecd.org/dac/development-aid-rises-again-in-2015-spending-on-refugees-doubles.htm).

<sup>2</sup> OECD, “Official development assistance – definition and coverage”, [www.oecd.org/dac/stats/officialdevelopmentassistance-definitionandcoverage.htm](http://www.oecd.org/dac/stats/officialdevelopmentassistance-definitionandcoverage.htm).

<sup>3</sup> Amartya Sen, *Development as Freedom* (New York: Oxford University Press, 1999).

<sup>4</sup> Development Initiatives, *Investments to End Poverty*, Bristol, 2013.

<sup>5</sup> OECD, “Aid to developing countries rebounds in 2013 to reach an all-time high”, April 8, 2014, [www.oecd.org/newsroom/aid-to-developing-countries-rebounds-in-2013-to-reach-an-all-time-high.htm](http://www.oecd.org/newsroom/aid-to-developing-countries-rebounds-in-2013-to-reach-an-all-time-high.htm).

<sup>6</sup> World Bank, *Migration and Remittances Factbook 2016*, p. 40, <http://go.worldbank.org/QGUCPJTOR0>.

<sup>7</sup> *Ibid.*, p. 29.

<sup>8</sup> United Nations, [www.un.org/apps/news/story.asp?NewsID=47029](http://www.un.org/apps/news/story.asp?NewsID=47029), and Development Initiatives, *Investments to End Poverty*, Bristol, 2013, p. 140.

<sup>9</sup> UNCTAD, “Foreign direct investment to Africa increases, defying global trend for 2012”, June 26, 2013, [www.unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=136](http://www.unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=136).

<sup>10</sup> World Bank, “2.21 World Development Indicators: Mortality”, <http://wdi.worldbank.org/table/2.21>.

<sup>11</sup> United Nations, *Millennium Progress Report 2013*, New York. The extreme poverty benchmark was set at US\$1.00 per day in 2000. It was adjusted to US\$1.25 in 2008 and to \$1.90 in 2015.

<sup>12</sup> Development Initiatives, *Investments to End Poverty*, Bristol, 2013.

<sup>13</sup> For more on the 2030 Agenda and the Sustainable Development Goals, see <https://sustainabledevelopment.un.org/sdgs>.