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DOES AID HAVE A FUTURE?

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ODA bashing has become a popular pastime. Apart from the periodic allegations that aid has little effect or that its effects are perverse, a wealth of material has been produced in recent years announcing the end of aid and sometimes claiming that its role in the development of poor countries is becoming marginal. The argument goes that globalisation of the economy and the liberalisation of capital would automatically lead to global economic convergence, rendering traditional aid obsolete. In the purest neo-classical tradition, the free play of the market and *laisser-faire* policy should promote the convergence of forms of production and consumption patterns, and the South would catch up as a result.

It is true that the world is changing. Wealth is shifting from the North to the South-East at a prodigious rate. New economic powers are emerging in the South. The world economy is structured around global value chains (GVCs) with production processes that transcend national borders. Capital is increasingly flowing from north to south and within the South. Aid once accounted for over 50% of net external flows of capital to the Developing Countries (DCs) when they were defined by the Development Assistance Committee (DAC) in 1969. Nowadays it represents at most 25%.

In this context, it is sometimes forgotten that the geography of aid has changed considerably in the past 50 years or so. Due to the rise in their per capita income, over 55 countries no longer fall into the DAC category of developing countries eligible for Official Development Assistance (ODA). Many are now emerging countries and even industrialised countries, having become members of the OECD (*e.g.* Korea, Turkey). As a consequence, aid to those countries has dried up. Some of them have become donor members of the DAC in their turn. Similarly, since the start of the 1990s, over 20 have risen from the Low-Income Country (LIC) category to the Middle-Income Country (MIC) category. Here again, ODA flows, particularly in their most concessional form, have slowed down and are being replaced by loans from public and private operators which are not concessional, or only to a minimal extent. In addition, the emergence of global financial capital and the excess liquidity of the economy, combined with the end of capital controls and the marked improvement in the macroeconomic situation of the countries of the old South, have encouraged faster movement of private capital seeking new opportunities. So it is no surprise that the proportion of aid in the net external flows to the southern countries has declined.

But the fact remains that developing countries have not disappeared thanks to the free market's invisible hand. This category now includes very diverse countries, from Niger to China, Afghanistan to Brazil, and reflects a South that has fragmented economically. Nowadays there are different Souths with widely varying economic trajectories. And within those Souths there is still an underdeveloped South; countries lagging far behind in average per capita income and other indicators of human development, facing structural obstacles which hamper economic growth and are highly vulnerable to exogenous shocks. Most of them are Least Developed Countries (LDCs), often fragile and always with low income. That is the traditional core target of development co-operation, and those countries remain highly dependent on ODA. It is difficult for them to connect to GVCs, and they attract little foreign capital, unless they have natural resources.

Historically, ODA has been defined as financial assistance from the industrialised countries for the **economic and social development of poor countries**. Those developing countries are listed by the OECD Development Assistance Committee (DAC) as eligible for ODA, chiefly because of their average per capita income. Hence aid was designed to assist poor countries, not poor populations. Thirty years ago, that was accepted without question, since there was a

[1] The ideas expressed in this paper are those of the author and do not necessarily represent views of the OECD, the OECD's Development Assistance Committee, their member countries, or the endorsement of any approach described therein.

strong correlation between poor populations and poor countries. Over 90% of the world's population living below the absolute poverty threshold was in the LICs. That is no longer the case. A growing proportion of the poor now live in MICs, including many of the upper middle income countries that are considered emerging economies.

The scope of co-operation policy has also been altered recently by other factors aside from income. Increasingly, addressing global issues such as climate change and transmissible diseases is included in its objectives. This development is to be welcomed, since such global risks concern all of us, and the poor countries are often the most vulnerable. However, since they often have small populations and are rarely the source of those risks, those countries could be the first victims of distortions in aid allocation, as measures to combat global risks are increasingly integrated into the aims of international co-operation.

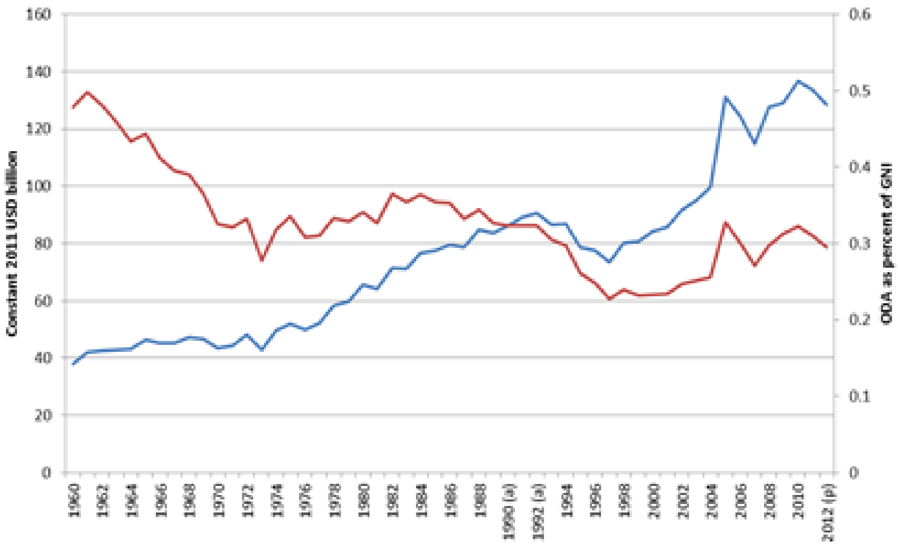
In the first part of this paper, I shall present the latest figures for aid to poor countries, to show that it still plays an important role. In the second part, I shall outline the risks associated with the trends in the geographical distribution of poverty and the growing concern for global issues. Finally, I shall suggest possible ways to ensure efficient and fair allocation of aid in a way that does not penalise the most vulnerable countries.

I. Aid to the Least Developed Countries

Global aid increase over the long term, by volume

The volume of global ODA has increased steadily over the past 50 years, rising from slightly under USD 40 billion in 1960 to around USD 130 billion in 2012, after peaking at USD 137 billion in 2010 (constant 2011 dollars).

Net ODA 1960 – 2012

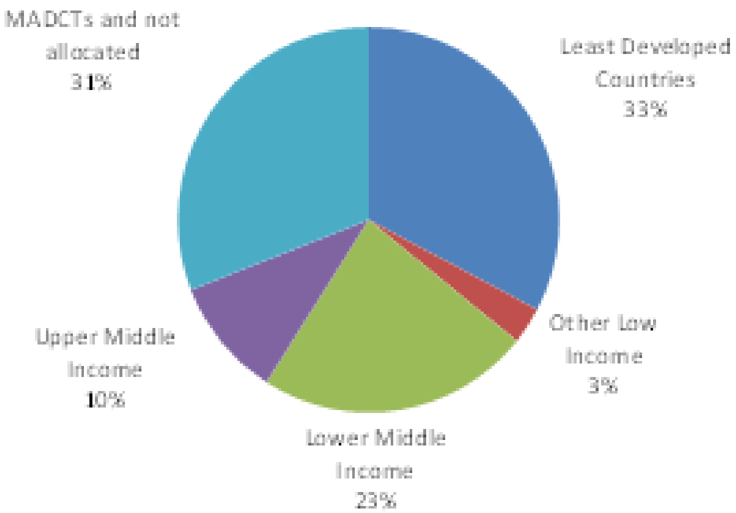


Between 2000 and 2010, the volume rose by 63%. That trend is particularly interesting in that it took place even when the number of beneficiary countries was declining significantly. At the same time, the number of donor countries increased, as some former beneficiaries became donors. Korea, for instance, progressed from a low-income country (LIC) in the 1960s to 16th out of the 29 DAC donors in terms of volume in 2012. Finally, global income has risen considerably, especially in the industrialised countries, eroding ODA in relation to gross national income (GNI), which in the same period fell from an average of 0.51% to 0.28% for DAC members.

Sharp rise in aid to LDCs in the past 10 years

In 2011, a third of total aid, but almost 50% of aid allocated geographically, was focused on LDCs.[2] That figure may be related to the proportion of LDCs in the population of developing countries (15%) and in the global population living below the absolute poverty threshold (30%). The LIC/MIC breakdown is 36% for the former compared with 33% for the latter.

LDCs allocated approximately a third of total aid
Average 2010-11



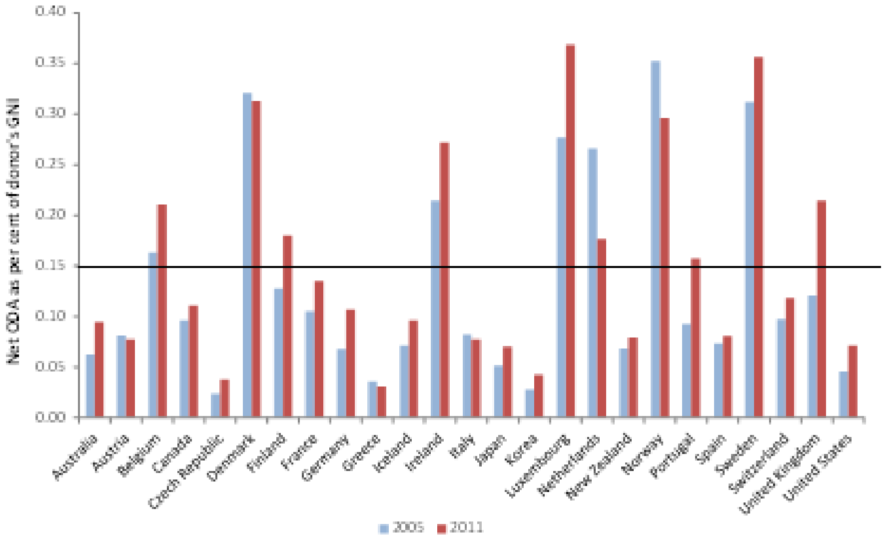
ODA to the LDCs has shown a sharp rise in the past 10 years. Whilst total ODA to all recipients increased by 63% in constant dollars between 2000 and 2010, aid to LDCs more than doubled in the period from 2000-2011, jumping from USD 22 billion to USD 46 billion[3]. The increase was even more marked in the case of the subset of LDCs on the list of fragile countries (+169%).

Thus not only has ODA increased over the 10-year period, but an effort has been made to focus on the most vulnerable countries.

There has also been an increase in ODA in proportion to GNI. Virtually all DAC donors have progressed towards the target set by the United Nations for aid to LDCs to represent between 0.15% and 0.20% of GNI. Ten DAC countries have now achieved 0.15% (compared with only five for the global target of 0.7%).

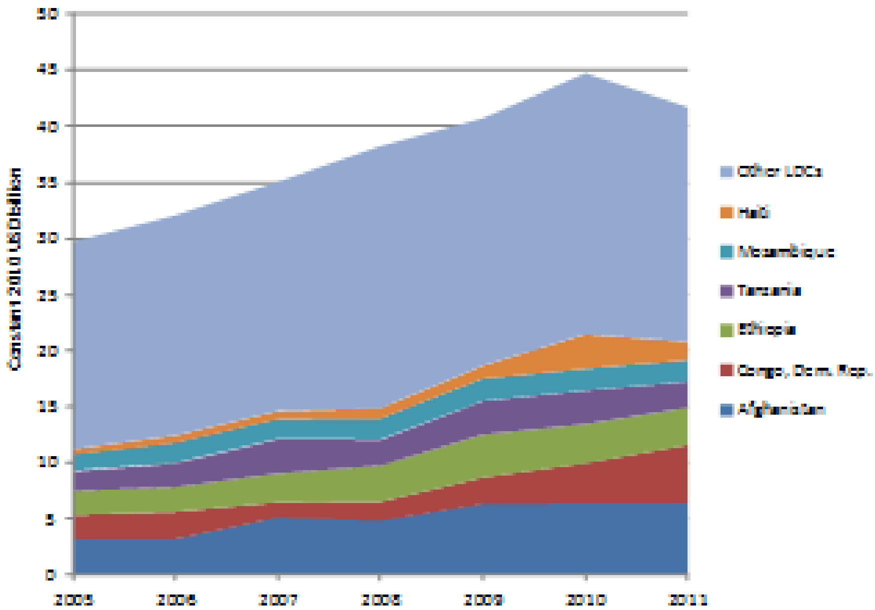
[2] One-third of global ODA is not *a priori* allocated geographically (*e.g.* contributions to global funds, regional and transversal programmes).
[3] In constant 2011 dollars.

10 DAC countries achieving the target of 0.15% of GNI for aid to LDCs in 2011



However, the aid is distributed very unequally. In 2011, six LDCs[4] received half of the total ODA allocated to that category. The remaining half was shared between the other 42 LDCs. Afghanistan alone received 15% of the total.

Six countries received approximately half of aid to LDCs in 2011



There are also enormous disparities in the per capita aid allocated. Per capita ODA allocated to LDCs ranges from USD 4 000 for Tuvalu to USD 18 for Madagascar and within this range, from USD 600 to the Solomon Islands, USD 200 to Afghanistan USD 200 and USD 68 to Burkina Faso.

[4] Afghanistan, Haiti, Mozambique, Tanzania, Ethiopia and DRC.

The comparison between Mozambique and Madagascar is striking. Of those two countries, which are geographically very close, the first is a priority target for 16 donor countries: it received USD 98 ODA/head, whereas the second received only USD 18 and is a priority aid country for only one donor. That situation presents a serious challenge for the fairness of aid globally. The fact that some countries receive much more assistance than others is not justified by any objective criteria. It is particularly worrying for the so called "aid orphans", a category identified by the DAC Secretariat on the basis of a range of criteria. In 2011, eight countries[5] were classified as "aid orphans", *i.e.* the per capita ODA they received was far below the average to which they would be entitled according to the different allocation criteria applied by bilateral and multilateral donors. Those countries are all LDCs.

ODA plays an essential role in financing development in LDCs and MICs

Notwithstanding the fashionable discussion of the growing role of other sources of development financing, particularly private investment, the LDC figures show that development is still mainly financed by ODA.

In the LDCs, ODA still accounts on average for more than 70% of net external flows and the equivalent of 40% of tax revenue.

The position is quite different in the MICs, where ODA represents on average only 6% to 18% of net external flows and 1% to 5% of tax revenue, according to whether these are lower or higher MICs.

Those figures are a clear indication of the differences in economic trajectories within the developing countries and what the author of this note calls the "fragmentation of the South". It is an economic fact that aid remains an essential component in financing the development of poor countries, which was, of course, its original aim. The figures also show that the international community needs to be more discerning in its development financing, by discriminating more between instruments according to the country's level of development. A fall in ODA for the LDCs could have a disastrous effect on the stability and development prospects of countries with little or no access to financial markets and direct foreign investment flows.

II. The universality/vulnerability debate and the risks in allocating aid

The world is changing, and development co-operation is adapting. Indeed, that is an important characteristic of development co-operation over the long term. Throughout its 50-year history, it has constantly reviewed its concepts, principles, forms of action and objectives in order to keep pace with international changes, both geopolitical and macroeconomic.

The new agenda being planned (post 2015) will certainly focus on two major aspects:

i. the aim of eradicating absolute poverty by 2030 (in place of Millennium Development Goal No. 1, which was to reduce the world's population living below the absolute poverty threshold by half between 1990 and 2015); and,
ii. greater attention to global risks, particularly environmental risks, in a universal agenda.

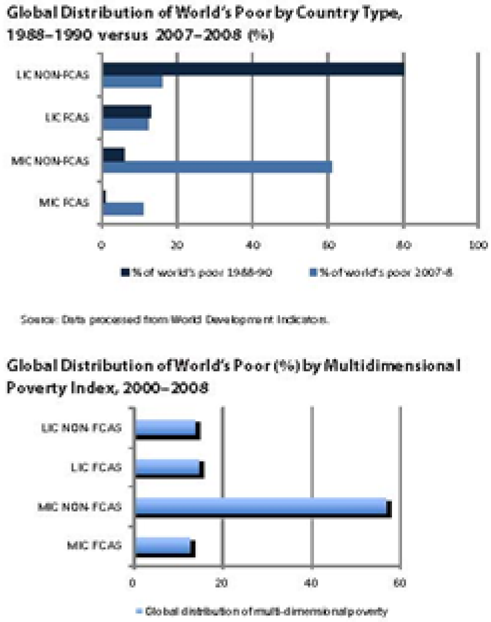
Such changes are necessary and justified. They should be supported. They are not incompatible with the aim of assisting the development of the poor countries particularly affected by poverty and global risks which could ultimately cancel out much of the progress achieved in human development. However, it is necessary to consider the possible implications of these new priorities for the allocation of aid, which, as stated above, is still an essential component of development financing for the most vulnerable countries.

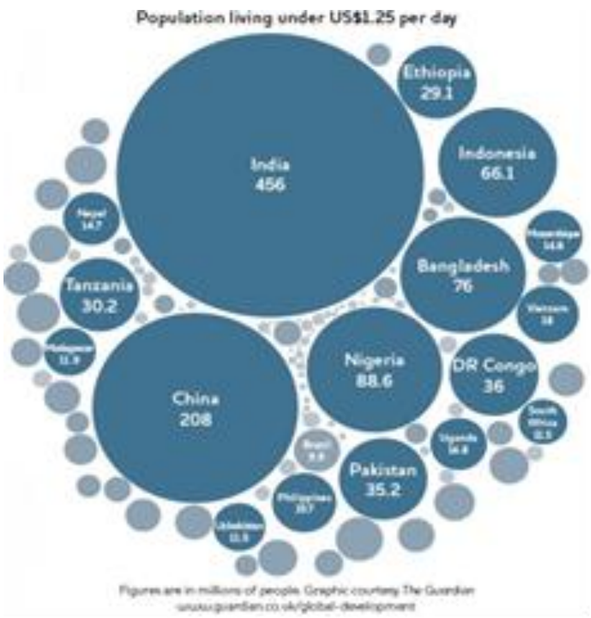
[5] Madagascar, Malawi, Bangladesh, Gambia, Guinea, Niger, Togo and Nepal.

The new geography of poverty

One of the main characteristics of the development of the world economy in recent years, as much as the drastic fall in the number of people living in absolute poverty in the world, is the growth of inequalities and relative poverty in every country[6], including industrialised and emerging countries. In the latter, the virtuous function of the Kuznets curve[7] is taking time to materialise, and it even seems to be reversed in the former, where inequalities are widening again after the strong convergence in the "Glorious Thirty" post-war years. In view of the global demographic and economic changes, a new geography of poverty is emerging, in which middle-income and emerging countries are increasingly prominent.

A new geography of poverty?





In fact, in absolute numbers, poverty (defined in absolute terms as the number of people living on a per capita income of under USD 1.25) is now concentrated mainly in the MICs, notably India, China, Nigeria and Indonesia. That is a major shift from the 1980s, when the vast majority of populations in absolute poverty were in the LICs. In 2010, as shown in Andy Sumner's diagram of the new bottom billion above, extreme poverty occurred mainly in the MICs (over 60%). That is largely due, on the one hand, to population growth and the size of the countries and, on the other, to the transition of many of those countries from the LIC to the MIC category over the past 20 years or so.

In terms of ODA allocation, particularly in the light of the goal of reducing absolute poverty, that trend presents a daunting challenge. Should the priority be to allocate aid according to the number living in poverty, *i.e.* target poor populations, or according to the incidence of poverty, *i.e.* target poor countries[8]? **Over 50% of the population of the LDCs lives below the absolute poverty threshold, and in some countries that proportion could be as high as 70%.**

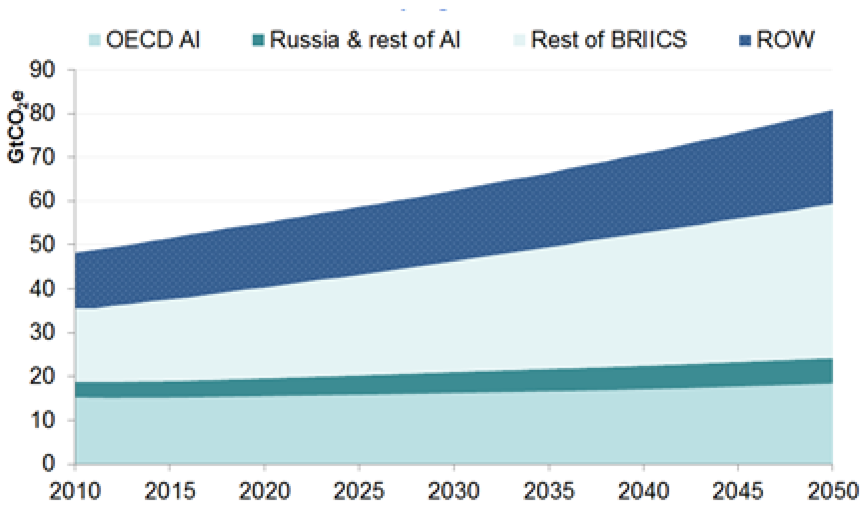
[6] OECD (2011), *Divided We Stand: Why Inequality Keeps Rising*, OECD, Paris.
[7] http://en.wikipedia.org/wiki/Kuznets_curve
[8] The incidence of poverty is defined as the proportion of the population of a particular country that is classed as poor.

This is not a neutral debate. Underlying it is a quasi-philosophical debate on aid: is its aim to combat inequality between countries and thus target the most vulnerable countries first, enabling them to deal with structural obstacles to growth and development? Or is it increasingly designed to correct domestic inequalities in the developing countries and to promote more inclusive growth in those countries by giving priority to the countries with the highest number of poor people? The answer to that debate also has serious implications for the legitimacy of aid in the donor countries. When these are facing a long-term slowdown in their growth, widening deficits and an increase in domestic poverty, the targeting of aid on middle-income countries with strong growth, notably the emerging countries, could have a long-term negative effect on public support for aid policies.

Global risks as a new frontier of aid

Another important trend in development co-operation is the growing attention being paid towards its objectives to combating global risks and promoting the provision of global public goods. This is a long-term trend. It is a direct consequence of globalisation and the realisation that we now live in a global village in which the development of our countries is increasingly dependent on policies and trends in other countries. Climate change is the most emblematic of these global risks.

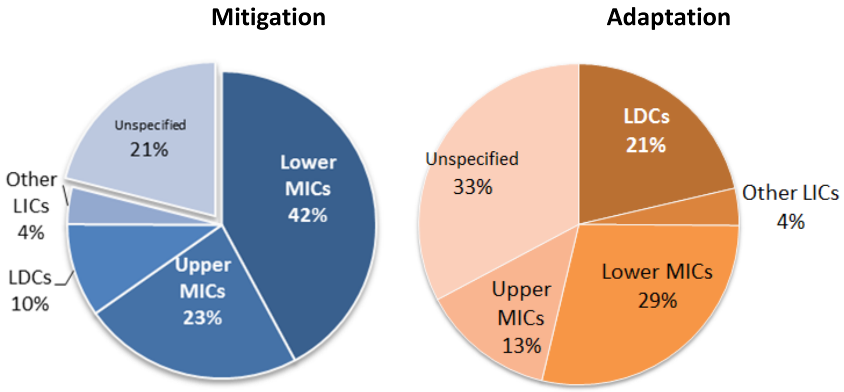
Climate change: 50% increase in greenhouse gas emissions by 2050



The above graph[9] shows that, with no change in production and consumption patterns, greenhouse gas emissions could increase by 50% between 2010 and 2050, bringing us to a warming rhythm of the globe's average temperature far above the two-degree objective agreed to in Copenhagen. The emerging countries (in this case BRIICS) are likely to be the majority contributors to this global trend, whilst the share of total emissions from OECD countries would decline and that of the other countries, including LICs, would progressively increase. As such it seems natural for mitigation measures financed by foreign aid to focus on the MICs and emerging countries.

[9] OECD (2011), *Environmental Outlook to 2050: The Consequences of Inaction*, OECD, Paris.

Differences in aid to combat climate change



The above pie charts illustrate the differences in aid to combat climate change, measured by the DAC with the Rio markers. Mitigation measures (on the left) are focused very much on MICs (65%), whereas LDCs, which have very low emissions, receive only 10% of the aid. A substantial share of the aid to mitigate climate change, defined as programmes targeted mainly on reducing greenhouse gas emissions, is thus directed at countries such as China (which has the highest gross emissions in the world, ahead of the United States) and Indonesia (fourth highest emissions). The allocation of aid for adaptation (on the right), designed to minimise the impact of climate change on populations, is much more balanced, with LDCs receiving 21%. The share allocated to MICs falls to 42% of the total, but most of the external aid is still concentrated on those countries.

III. Possible solutions for effective and fair allocation of aid

Development co-operation is necessary and will need to grow in the future. In the global village, to paraphrase André Malraux: *"the 21st century will be the century of co-operation or it will not be at all"*. The porosity of borders to flows of capital, goods and persons is structural. The growing strength of global risks is a major factor in the potential destabilisation of our classic development models. No one can escape his global responsibilities, even if these differ from one country to another.

Development co-operation needs to adapt once again to a changing world. It has to incorporate this new geography of poverty and the global risks that threaten the development of all, but especially of the most vulnerable countries. It is highly desirable for the post-2015 agenda to include universal objectives, both for the reduction of absolute poverty and for sustainable development. For the first time, we have the opportunity to eradicate absolute poverty. But we also have to change our growth model to avoid permanently jeopardising the welfare of future generations.

Having said that, pursuance of those objectives should not prevent us considering the risks resulting from the universalism of the agenda and its impact on the allocation of aid to the most vulnerable countries. There are solutions, with two main options:

i. Allocating aid according to need: giving more to those who have least

The first option is to distinguish between target populations, giving the poorest countries priority in the allocation of aid.

Three types of criterion might be applied:

– Poor countries: in this case, poverty will be measured not in absolute terms (number of poor people as an absolute value) but by incidence (number of poor people in the total population). In the light of recent research into poverty, it would be sensible not merely to measure monetary poverty (per capita monetary income) but to try and include other indicators (multidimensional poverty).

– Countries lagging behind with the universal development goals: aid is then seen as financial assistance to help the developing countries lagging furthest behind with the universal development goals to catch up.

– Countries that are vulnerable or face structural obstacles to development: that is the *raison d'être* of the LDC category, which identifies countries facing structural obstacles to development and/or particularly vulnerable to exogenous impacts. The idea is therefore to try and offset the initial inequalities by increasing the opportunities of the most vulnerable countries and enabling them eventually to join the growth path of the majority.

Those criteria may be combined to try and define a model for aid allocation that covers poverty, delays in implementing the global development goals and vulnerability. They may also, to a certain extent, be combined with the measurement of results or impact.

They may be used to define systems for allocating co-operation agencies' own resources. But they may, in particular, allow a new target to be set for ODA in the next few years. Rather than continuing to focus on a general target (the 0.7% target set at a time when the list and macroeconomic situations of the donor and developing countries were very different from what they are today), those indicators could be used to set a concessional financing objective targeted at the countries most in need, whether they are called poor, vulnerable or fragile.

ii. ***Discriminating between instruments to take account of the level of development and/or optimise the complementarity of aid instruments***

In this second approach, the most concessional aid – by definition a rare source of financing for development – would be targeted at the most vulnerable and/or poorest countries. Instruments that were not concessional, or only to a very limited extent, could finance the achievement of the universal goals in the MICs and/or finance sectors that could be financed by market instruments. The aim here is to fit in with a universal agenda and support all developing countries, whilst discriminating between the instruments used to optimise complementarity.

Some donors are already discriminating in that way, for example through the concept of differentiated partnerships introduced by France and the European Union to promote more consideration for global risks in development co-operation objectives, whilst still giving priority to poor countries in the classic approach to poverty reduction.

Once again, combating climate change is an illustration of that strategy. Thus, although the mitigation programmes are largely concentrated on MICs, it is also true that aid in that sector is, to a large extent, financed by concessional loans (two-thirds), whereas adaptation programmes, which are more targeted at LICs, are mostly financed by grants. And a growing number of mitigation programmes are financed by non-concessional instruments (loans, guarantee instruments, acquisitions of holdings) which are not counted as ODA. Similarly, the trend in financing of the energy sector in the developing countries is a good example of that discrimination between instruments. Whereas, at the beginning of the last decade, most financing allocated for access to energy in the developing countries was targeted at non-renewable energy from concessional sources (highly concessional grants and loans), programmes of that type are now largely targeted at renewable energy and financed by non-concessional resources.

Here again, all combinations are possible and mechanisms which combine (a) indicators to measure need and (b) discrimination between instruments might be created for planning development financing.

Conclusion

The world is changing. It is diversifying, in both the South and the North. Development co-operation has to incorporate new goals in an increasingly complex vision of growth, development and welfare. Development financing has to be part of a more global and comprehensive vision in which the various sources of financing are compared in order to find the best possible combinations to ensure full complementarity and greater overall efficiency. Certainly, market instruments and private investment can play a growing role, especially in financing economic growth and infrastructure. Nonetheless, it is important to avoid confusion. Not all external flows can be used to finance development, and the main objective of private investment is not to promote the economic and social development and improve the welfare of the most deprived populations, which is the *raison d'être* of aid. Private investment can be involved, on certain conditions. And there is no doubt that aid can provide considerable leverage to increase private flows and also increase their impact.

But supporting a modern view of development co-operation and a more comprehensive and dynamic approach to development financing in which market instruments all have their place should not lead us to ignore or minimise the role of ODA. In the poorest and most vulnerable countries, it remains an important component in the financing of public policies. With the South fragmenting along very different economic trajectories, we must redefine how we target and prioritise it and re-evaluate its rules. **But it still has a key contribution to make to sustainable development and international solidarity.**