4.6 The Roles of Foreign Aid and Multilateral Development Assistance

Classifications and types of aid

- Explain that aid is extended to economically less developed countries either by governments of donor countries, in which case it is called official development assistance (ODA), or by nongovernmental organizations (NGOs).
- Explain that humanitarian aid consists of food aid, medical aid and emergency relief aid.
- Explain that development aid consists of grants, concessional long-term loans, project aid that includes support for schools and hospitals, and programme aid that includes support for sectors such as the education sector and the financial sector.
- Explain that, for the most part, the priority of NGOs is to provide aid on a small scale to achieve development objectives.
- Explain that aid might also come in the form of tied aid.
- Examine the motivations of economically more developed countries giving aid.
- Compare and contrast the extent, nature and sources of ODA to two economically less developed countries.

Foreign aid is defined simply as, "money, food, or other resources given or lent by one country to another." Notice that aid can be "given" (meaning there is no expectation of repayment) or "lent" (in which case, the recipient country is required to repay some of what is given to the donor country).

The vast majority of the over $150 billion in aid given annually is in the form of **official development assistance (ODA)** which is aid extended by one government (the donor) or from multilateral development institutions such as the World Bank and the International Monetary Fund (IMF) to another government (the recipient).

Aid is also extended, but at a much smaller level, by **nongovernmental organizations (NGOs)**. Some well-known examples of NGOs providing aid to economically less developed countries, along with their primary focuses, include[14]:

- The Bill and Melinda Gates Foundation - global health
- World Vision - food aid and emergency assistance
- Oxfam - poverty alleviation and debt relief
- Doctors without Borders - healthcare services
- CARE International - poverty alleviation
- International Committee of the Red Cross - humanitarian relief

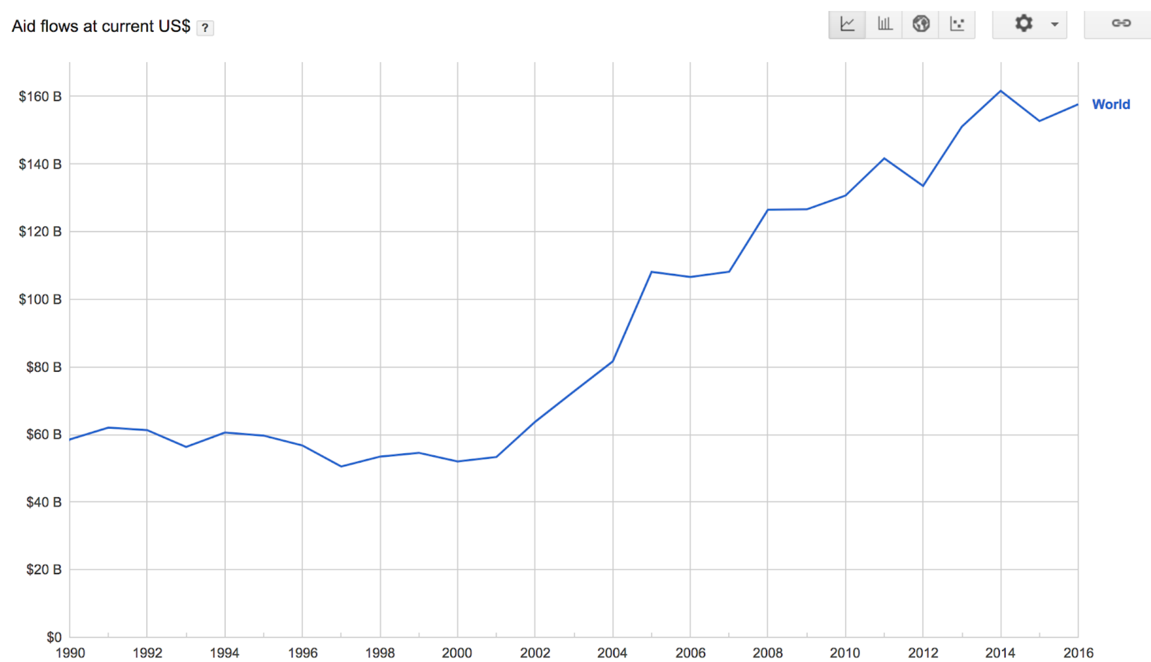
While these well-known organizations target specific areas of economic development, aid in

[14] Source: "The World's Most Powerful Development NGOs" https://foreignpolicy.com/2008/07/01/the-list-the-worlds-most-powerful-development-ngos/

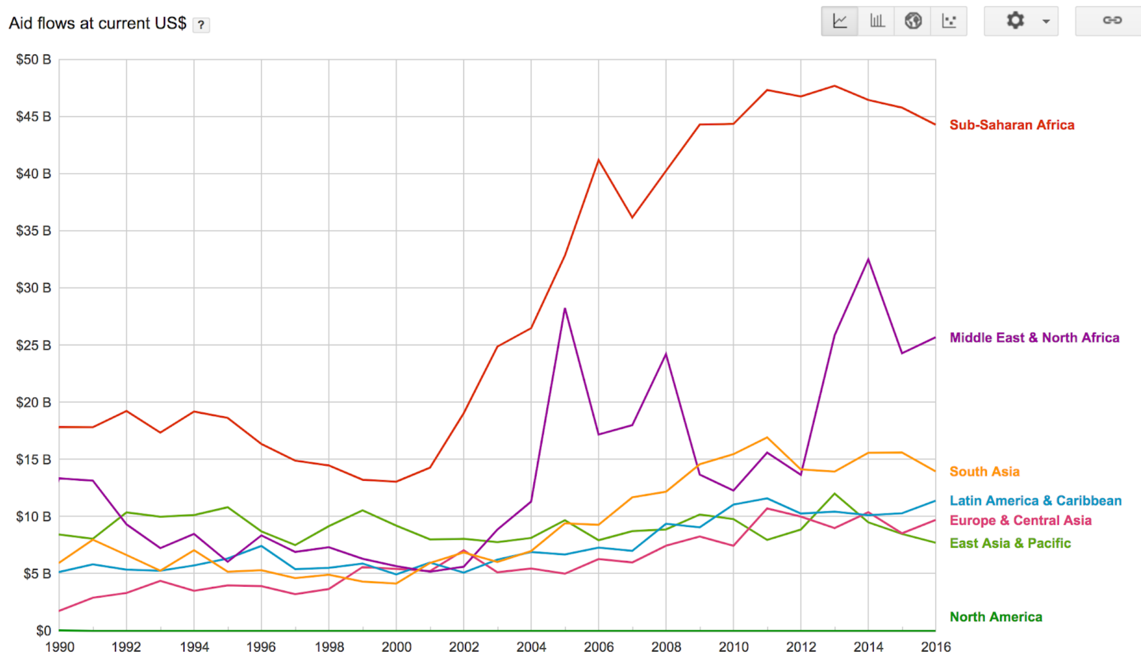
general falls into one of two categories, summarized in the table below.

Foreign Aid	
Humanitarian Aid	Development Aid
Examples: food aid, medical aid, disaster relief aid	Examples: grants, concessional loans, project aid, programme aid

Most official development assistance (government to government) is in the form of development aid. The chart below shows the dollar value of ODA extended worldwide from 1990 to 2016.



At last count over $150 billion per year was being extended in foreign aid, mostly from rich countries to poor countries. When we look at aid flows by region, we can see where most of the money given for development assistance is flowing to.



Notice from the chart that the region receiving by far the largest proportion of foreign aid is the 54 countries of sub-Saharan Africa, where around 1 billion people live and where average incomes are lower than in any other region of the world.

Development aid comes in many forms. Below we'll define each:

- **Grants** are money gifted by a government to another government for the purpose of improving the country's infrastructure or other factor contributing to economic development. Grants are not required to be repaid by countries that receive them.
- **Concessional loans** are money lent by a government to another government, at least 25% of which does not have to be repaid. A loan is "concessional" in nature when the interest rate is below what the recipient country could receive from a private lender, which classifies such loans as "aid."
- **Project aid** is money given for specific investments in healthcare, education, or other infrastructure (hospitals, schools, ports, railways, bridges, etc…)
- **Programme aid** is money given to a country that is not designated for a specific project, including money to help balance a government's budget or to stabilize its currency's value on the forex markets.

Tied aid

According to the Organization for Economic Cooperation and Development (OECD), **tied aid** describes "official grants or loans that limit procurement to companies in the donor country or in a small group of countries.[15]" In other words, when a government makes a grant or a loan to another government, but requires the recipient to use the money to buy technology or hire services from companies in the donor country.

[15] Source: "Untying aid: the right to choose" http://www.oecd.org/development/untyingaidtherighttochoose.htm

Tied aid is aid with "strings attached." It effectively limits the ability of the recipients to "shop around" for the best value for the goods, services, or work it wishes to invest in with the granted or loaned funds. Tied aid acts as an indirect stimulus to the donor country's economy, masked as development assistance for a poorer country. Since the money has to be spent in the donor country, it boosts domestic output and employment at the expense of the recipient having the freedom to choose how where and how to spend the money in a way that maximizes its impact on the country's development.

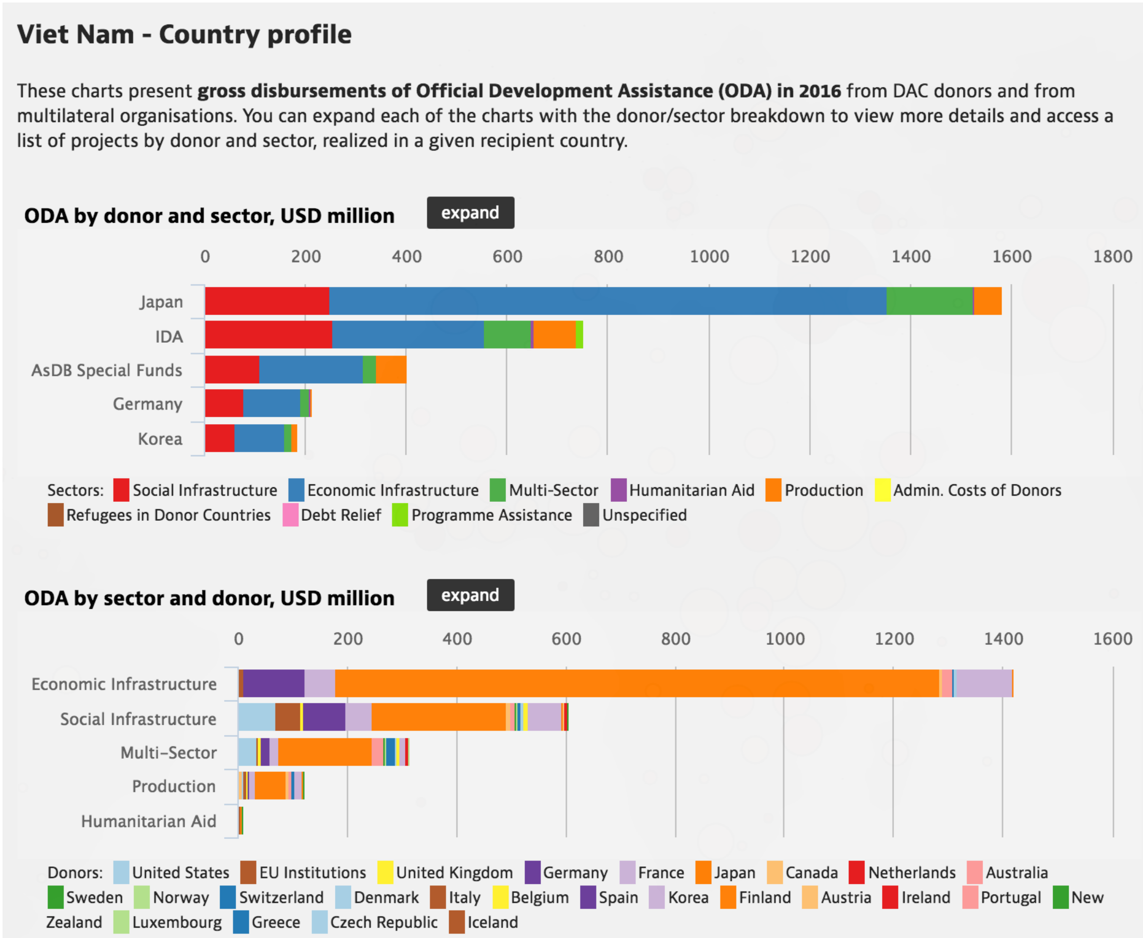
According to the OECD, the proportion of aid that is "untied" (e.g. the recipient is able to spend it wherever it gets the most bang for the buck) has increased from 46% to 82%, vastly increasing its potential impact for good in the recipient countries.

Tied aid provides an obvious benefit for the donor country, but untied aid can stand to benefit both the recipients and the donors. What may appear as a "selfless act" can in fact benefit both sides of the aid transaction. Donor countries (mostly rich, more economically developed countries) are better off when the rest of the world experiences rising incomes, longer lives, and greater levels of education and health.

Motivations for donor countries
Improving development in poor countries creates more consumers for rich country firms, a better educated workforce willing and able to contribute to global production, and greater economic, political, and social stability, all of which contribute to favorable conditions for economic growth and increased revenues for firms and higher incomes for households in rich and poor countries alike.

Foreign aid case study #1 - Vietnam
In 2016 Vietnam received $2.37 billion in official development assistance, making it the world's third largest recipient nation after Afghanistan and India[16]. The graphic below breaks down the extent, nature, and sources of the ODA received by Vietnam in 2016[17].

[16] Source: "Aid at a glance charts" from the OECD
http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm
[17] Source: "Compare your country: Aid statistics by donor, recipient, and sector"
http://www2.compareyourcountry.org/aid-statistics?cr=302&cr1=oecd&lg=en&page=1



Notice from the chart that the largest donor country to Vietnam was Japan, followed by "IDA", or the International Development Association, the part of the **World Bank** that helps the world's poorest countries. According to the World Bank,

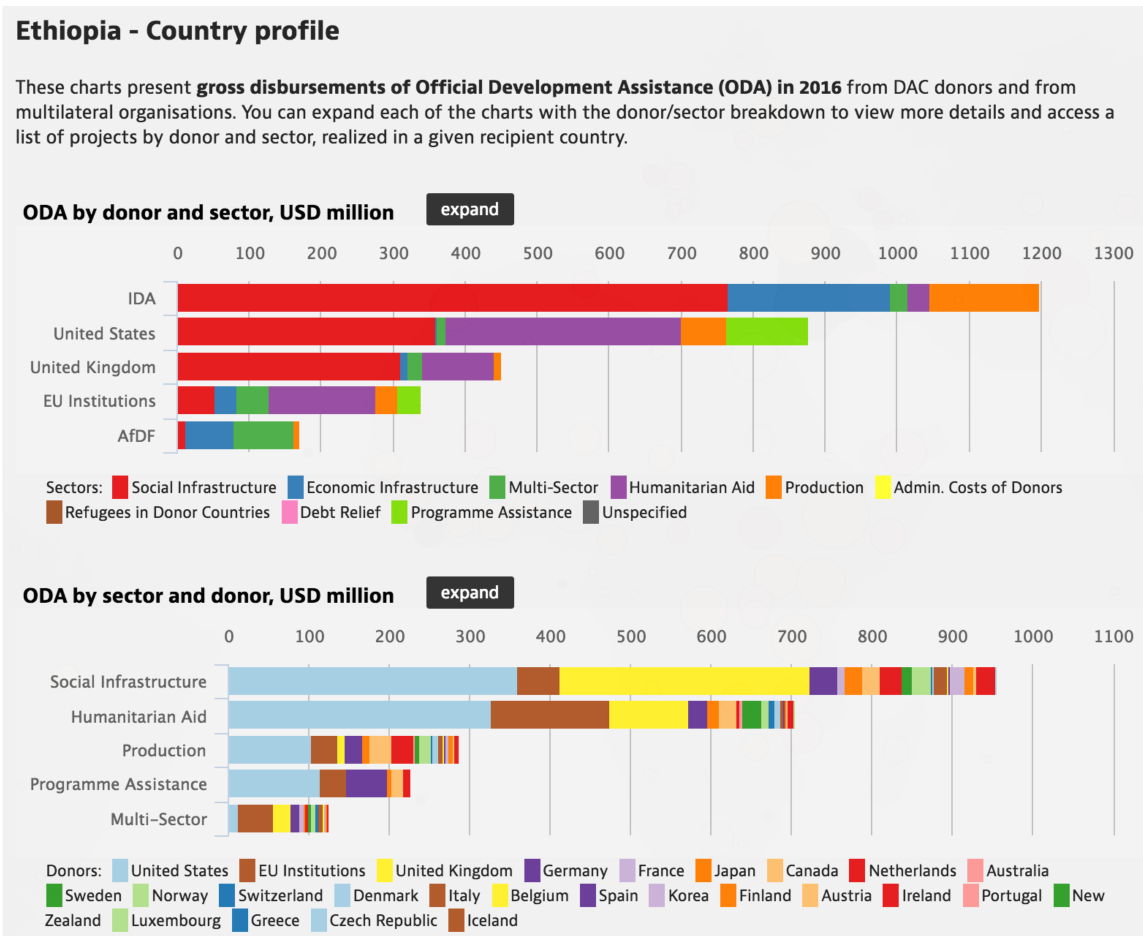
> The IDA aims to reduce poverty by providing loans (called "credits") and grants for programs that boost economic growth, reduce inequalities, and improve people's living conditions.
>
> IDA is one of the largest sources of assistance for the world's 75 poorest countries, 39 of which are in Africa, and is the single largest source of donor funds for basic social services in these countries.
>
> IDA lends money on concessional terms. This means that IDA credits have a zero or very low interest charge and repayments are stretched over 25 to 40 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress.

The colors in the top half of the chart represent the sectors within Vietnam that received aid, including "economic infrastructure" (the roads, bridges, transportation hubs, communication technologies, and other physical infrastructure that makes a country's economy function efficiently) and "social infrastructure" (which includes schools, universities, hospitals, housing, and other goods that improve social welfare).

As we can see from the bottom of the chart, humanitarian aid makes up only a tiny proportion of Vietnam's total aid, which is almost entirely in the form of development aid.

Foreign aid case study #2 - Ethiopia

In 2016 Ethiopia was the world's fifth largest recipient of official development assistance, receiving $1.98 billion.[18] Below we can see the extent, nature, and sources of aid received by Ethiopia.



Like Vietnam, the IDA wing of the World Bank is a major donor to Ethiopia, providing $1.2 billion of its almost $2 billion in total aid. Concessional World Bank loans are being used largely to provide social infrastructure to Ethiopia (schools, clinics, hospitals, etc), followed by economic infrastructure.

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[18] Source: "Aid at a glance charts" from the OECD http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm

Following the IDA is the United States, which unilaterally provided Ethiopia with almost $900 million in aid, much of which was in the form of humanitarian aid.

Notice also that compared to Vietnam, which received almost no humanitarian aid, over a third of the aid received by Ethiopia ($700 million) was humanitarian. The difference can be explained by the fact that Vietnam is a relatively rich country that is not as prone to humanitarian emergencies like drought, conflict, flooding, and outbreaks of disease as compared to Ethiopia.

Evaluation of foreign aid

- Evaluate the effectiveness of foreign aid in contributing to economic development.
- Compare and contrast the roles of aid and trade in economic development.

There has been much debate over the effectiveness of aid in contributing to economic development. On one side of the discussion are economists like Columbia University's Jeffrey Sachs, who argued in a January 2014 column in *Foreign Policy Journal* that "the recent evidence shows that development aid, when properly designed and delivered, works, saving the lives of the poor and helping to promote economic growth." As evidence, Sachs points to the reduction in instances of malaria in sub-Saharan Africa since the turn of the 21st century[19]:

> At the turn of the new century, malaria was front and center of the global aid debate. Research by myself and others, and evidence garnered in the report of the World Health Organization (WHO) Commission on Macroeconomics and Health that I had the honor to chair, showed that in addition to being a health catastrophe, malaria imposes a significant economic burden, particularly in sub-Saharan Africa. Luckily, though, the world was starting to take notice. In 2000, the U.N. Millennium Declaration, The African Summit on Malaria, and the G8 Declaration all addressed the burden of malaria and committed the world to action. The debate soon turned to the issue of policy: how could the malaria burden be reduced?
>
> The combination of bed nets and effective medicines, supported by rapid diagnosis of infections, makes for a powerful one-two punch in saving lives and reducing malaria transmission.
>
> Without financial support, poor people could not afford either the (bed nets) or the new medicines. Attempts to sell the nets at a discount, known as social marketing, had very little take up, since many poor families simply lacked any cash income at all. The prospect of achieving "mass action" protection through social marketing was very small. Moreover, impoverished households would often scrape together the needed money only to buy the cheaper but ineffective nets, rather than the more

[19] Source: Sachs, Jeffrey. "The Case for Aid" *Foreign Policy*, January 21, 2014 https://foreignpolicy.com/2014/01/21/the-case-for-aid/

expensive but more effective (ones).

Governments of low-income African countries needed donor support for the scale-up effort since their own domestic tax revenues, even when amply allocated to public health, could not cover the costs of a basic primary health system including scaled-up malaria control. The financial calculations, laid out by the Commission on Macroeconomics and Health, showed that an impoverished country with a GDP of around $500 per capita, typical for a poor country in Africa, may be able to muster around $15 per person per year out of domestic revenues for primary health, while the costs of a basic public health system would be around $50-$60 per person per year.

… The WHO (World Health Organization) swung its powerful weight behind the mass free distributions of bed nets throughout sub-Saharan Africa. Soon after, U.N. Secretary-General Ban Ki-moon established the mass free distribution of bed nets as policy for all U.N. agencies, and called on the world's governments and NGOs to support the scale-up effort. Ban's leadership tipped the global scales decisively. Close to 300 million bed nets were freely distributed from 2008-2010, with the Global Fund to Fight AIDS, Tuberculosis and Malaria and the U.S. President's Malaria Initiative program paying for a substantial share of the scale-up.

The evidence is overwhelming that malaria declined precipitously as a result of these bold measures. WHO's latest report finds a stunning 51 percent drop in malaria deaths of African children under the age of five between the years 2000 and 2012. These results are historic. Roughly a half-million children, if not more, are being saved each year that otherwise would have succumbed to malaria.

According to Sachs and other aid proponents, without the work of both NGOs and official development agencies and the governments that support them, the poverty reduction and improvements in health and education experienced across the developing world in recent decades would have been significantly less pronounced.

On the other side of the debate are economists like New York University's William Easterly, who argues that due to factors like a lack of accountability and feedback, corruption, and the fact that recipient countries can become dependent upon and beholden to donor countries, rather than developing their own capacities as contributors to global trade, aid has failed to achieve meaningful improvements in the development of poor countries.

According to Easterly[20],

Economic development happens, not through aid, but through the homegrown efforts of entrepreneurs and social and political reformers. While the West was

[20] Source: Easterly, William "Why aid doesn't work?" CATO Unbound, April 2, 2006 https://www.cato-unbound.org/2006/04/02/william-easterly/why-doesnt-aid-work

> agonizing over a few tens of billion dollars in aid, the citizens of India and China raised their own incomes by $715 billion by their own efforts in free markets. Once aid agencies realize that aid CANNOT achieve general economic and political development, they could start concentrating on fixing the system that fails to get 12-cent medicines to malaria victims.
>
> The two key elements necessary to make aid work, and the absence of which has been fatal to aid's effectiveness in the past, are FEEDBACK and ACCOUNTABILITY. The needs of the rich get met through feedback and accountability. Consumers tell the firm "this product is worth the price" by buying the product, or decide the product is worthless and return it to the store. Voters tell their elected representatives that "these public services are bad" and the politician tries to fix the problem.
>
> Of course, feedback only works if somebody listens. Profit-seeking firms make a product they find to be in high demand, but they also take responsibility for the product —if the product poisons the customer, they are liable, or at least they go out of business. Elected representatives take responsibility for the quality of public services. If something goes wrong, they pay politically, perhaps by losing office. If it succeeds, they get the political rewards.
>
> Aid agencies can be held accountable for specific tasks, rather than the weak incentives that follow from collective responsibility of all aid agencies and recipient governments for those broad goals that depend on many other things besides aid agency effort. Examples of the latter include such unaccountable goals as the very fashionable campaign to achieve the UN Millennium Development Goals, or the sweeping goals of economic growth, government reform, and democracy for poor countries mentioned above. If a bureaucracy shares responsibilities with other agencies to achieve many different general goals that depend on many other things, then it is not accountable to its intended beneficiaries—the poor. No one aid agent is individually responsible for successfully achieving any one task in the current aid system. Without accountability, then the incentive for finding out what works is weak. True accountability would mean having an aid agency take responsibility for a specific, monitorable task to help the poor, whose outcome depends almost entirely on what the agency does. Then independent evaluation of how well the agency does the task will then create strong incentives for performance.

At the very least, opponents argue, aid has played a secondary role, while the primary driver of economic development has instead been the opening up of global markets to less economically developed countries, trade liberalization, foreign direct investment, and other market-oriented approaches to raising incomes and reducing poverty.