Bauer's "Foreign Aid, Forever? Critical Reflections on a Myth of Our Time"– revisited 50 years later

By Wolfgang Mostert, February 2022

Abstract: *The theory and practice of international development assistance has undergone profound changes since the 1960s. Originally, aid intended to combine external finance with technical assistance to eliminate three gaps believed to prevent development: the investment-domestic savings gap, the foreign exchange gap, the capacity gap. Since the 1990s, the scope expanded with increasingly deeper involvement in the internal affairs of low-income countries (financing of "national public goods"; changing the governance structure); simultaneously a growing share of finance is directed towards "global goods" issues (environment, refugee crisis, etc). Since the 2000s China emerged as a heavyweight in international development finance, financing large-scale infrastructure investments in transport and energy with loans at near-commercial terms. Presently both approaches – the Western and the Chinese – need adjustments to make them more relevant for today's global challenges. The paper presents recommendations for a new finance structure.*

The 1960s theory of economic development and aid

In the 1950s, nine countries in Southeast Asia, four in the Middle East, and two in Sub-Saharan Africa gained their independence; in 1960, the list expanded with 15 sub-Saharan African countries.[1] There was a consensus among Western economists and politicians that the countries needed external assistance for development. Zaire, for example, had in 1960 only 18 university-educated national staff; and the infrastructure of the former colonies was built primarily to satisfy the need for 'North-South' trade in goods, not for internal and regional economic development. There was also a consensus that the knowledge for how to deliver effective assistance was available. Economic growth theory, including Rostow"s "Five Stages of Economic Growth",[2] showed the path of development. The "Cobb-Douglas" model of economic growth[3] along with the theory of the 'double financial gap'[4] justified the need for financial assistance. Technical assistance could address problems of limited 'absorption capacity'[5]. The Marshall Aid of 1948-1951 had demonstrated how the combination of know-how transfer and financial assistance could deliver economic growth. Therefore, when the Danish Parliament in 1962 passed the "Law on Cooperation with developing countries", it was unanimous.

Peter Bauer's critique of foreign aid

A few critical voices were raised. In 1973, when the United Nations passed a resolution calling on rich countries to spend 0.7% of their GDP on foreign aid, Professor P.T. Bauer, a long-term critique of

[1] The list of countries can be found at https://en.wikipedia.org/wiki/Year_of_Africa

[2] Rostow's five stages are: Traditional Society. Preconditions to Take-off. Take-off. Drive to Maturity. Age of High Mass Consumption

[3] In its simplest form, the model sees a country's economic growth rate determined by its savings ratio divided by the investment output ratio.

[4] The theory sees the development of less developed countries limited by two gaps: (i) domestic savings are too small to finance a level of investment needed to create "take-off"; (ii) export earnings are insufficient to finance the imports necessary for development.

[5] The theory sees developing countries' ability to absorb financing and investment flows in their initial development limited by insufficient technical-administrative capacity.

foreign aid, summarised his points in the article “Foreign Aid, Forever? Critical Reflections on a Myth of Our Time”.

Present day foreign aid can be broken up into three main components: *development aid* (for physical infrastructure, institutional development, health, education, poverty alleviation), *humanitarian aid* (starvation, natural disasters, support to refugees and to countries receiving refugees), *climate finance aid* (for mitigation, adaptation).

Climate aid was not yet relevant in 1974 and Bauer did not attack humanitarian aid. His question mark concerned development aid, calling it an act of faith: “The case for foreign aid is regarded as axiomatic, so that either progress or lack of progress can be used to argue for more aid”. Bauer’s overall economic argument against aid as a tool for progress was simple: “where the mainsprings of progress are present, material progress will come about without foreign aid. Where they are absent, no amount of aid will help”. If the personal and social conditions of material progress (capacities, motivations, mores and institutions) are not present, aid will be unproductive and therefore ineffective. If, on the other hand, conditions for development other than capital are present, capital will be generated locally or supplied to governments and businesses from foreign sources of finance on a commercial basis. The Marshall Plan, a program to reconstruct Western Europe after the second World War, succeeded because efficient institutional, management, and technical capacities already existed in Europe. Countries such as Singapore, Malaysia and Taiwan successfully moved up the development ladder, not because of foreign aid but because of domestic drivers. The two-gap model was a myth: if poverty prevented sufficient capital accumulation, development into modern industrial societies would not have happened. Bauer noted “a patronizing attitude pervades the whole discussion on aid” and asserted a number of negative repercussions of aid on the internal situation of recipient countries, claiming that the official aid “reinforces the disastrous tendency to politicise life in poor countries”;. . “influences policies into inappropriate directions by promoting unsuitable external models”, that “the hand-outs increase the power, resources, and patronage of governments compared to the rest of society”.

The late 1980’s Washington consensus model for development finance

In the following decades, the majority of international development aid of several billiards dollars up to 2020 was used for the development of basic infrastructure in the form of roads, bridges, hospitals, schools, water and energy supply, as well as for capacity and institution building. It was not pure altruism: until the collapse of the Soviet Union in 1991, foreign aid was the main political and economic instrument in the east-west conflict's race for sympathy in the "Third World".

The collapse of the Eastern bloc in the late 1980s removed the Soviet-Russian planned economy as a competing model of inspiration in developing countries. This led to the global conviction that the Western system, with its combination of an open liberal economy dominated by the private sector and governed by a democratically elected government, was the surest recipe for economic growth. Donors and many developing countries accepted the so-called "Washington consensus" (between the World Bank and the IMF) that fiscal discipline, the liberalisation of financial markets, the privatisation of state monopolies, the removal of trade barriers and foreign direct investment were the most effective means of driving growth in developing countries. . An increased inflow of private funding was seen as a necessity, as the need for investment in infrastructure in the developing world was much greater than donor and government funding in beneficiary countries could cover.

Until then, many developing countries had experimented with different development strategies, such as import substitution (especially in Latin America) and government planning, with the creation of state enterprises to build essential infrastructure and a national manufacturing industry. The new paradigm of private sector-driven development led developing countries to open up their economies and financial markets in the 1990s and early 2000s to easier access to foreign capital and trade. The paradigm recommended the deregulation and privatization of former monopoly markets to increase investment in the sectors through private finance and achieve higher efficiency through the forces of competition. The markets for the supply of water and electricity were typically divided into 'commercial areas' in densely populated cities where suppliers did not receive subsidies, and 'non-commercial areas' in sparsely populated rural areas. In the latter, infrastructure and operation were supported by subsidies to suppliers, so that the price of services could be kept down to a level reflecting the ability of households to pay. In this context, "smart subsidies" - identifying financial instruments to minimise public spending on aid - became a buzz word in development aid. Some middle-income countries managed to implement comprehensive reforms to promote private investment in infrastructure, low-income countries were only able to introduce a few elements.[6]

"Leverage of private finance" became another buzz-word: mobilizing private finance capital for priority projects and sectors through financial constructions, mixing donor grants with private capital to subsidize hedging for private co-investors' investment. Examples of the structured finance instruments include credit guarantees, 'blended finance', where grants from a donor co-finance a project with a loan from a development bank, and 'layered investment funds', where a grant of 10-20% of the fund's capital funds the top loss-absorbing step. As investments in infrastructure in developing countries have a higher risk than in developed countries, private investors (project developers, investment funds and commercial banks) demand a higher financial return as compensation. At project level, risk reduction ensures that investments in capital-intensive renewable energy technology can compete with less capital-intensive fossil energy technologies. At macro-financial level, the aim is to increase the amount of private capital made available for investment in developing countries. Regulatory framework prevents 'institutional investors' (insurance companies and pension funds) from investing in projects whose risk level exceeds a red line. Development banks such as IFC, EBRD, EIB, EBRD, IFU also make co-financing of a private project dependent on the investment not exceeding a defined risk threshold. Since they obtain the funds for their loans by issuing bonds on the international capital market, they must protect their 'AAA rating' in order to avoid rising prices for their borrowing.

<u>Result of the Washington consensus model: mobilisation of private North-South finance</u>

The model succeeded in mobilizing private capital. In the decade 2010-2019, the external financing of public borrowing requirements by developing countries was increasingly covered by loans from commercial banks and by the issuance of government bonds on the international capital market. Private funding increased by 10% per year compared with 2% for funding from public sources. In 2010, funding from public sources was twice as high as from private ones; in 2019, the shares were equally large.[7] The trend was due to both demand and supply factors. Economic growth moved

[6] Vivian Foster & Anshul Rana: "Rethinking power sector reform in the developing world", World Bank 2020
[7] Akihiko Nishio og Gaiv Tata, "How the structure of global aid and development finance is changing". Brrokings.edu future development blog.November 3, 2021

some countries out of the low-income group that can receive World Bank's concessional IDA loans.[8] The World Bank's more expensive IBRD loans[9] - granted to middle-income countries – carry an interest rate which is only marginally lower than for debt finance from the international capital market (terms depend on the country's credit rating). Western countries' quantitative easing after the 2008 financial crisis drove down the price of bonds. The pursuit of higher yields, enticed investors to increase their risk appetite and take a greater interest in emerging markets. This widened the range of countries that could sell government bonds on the international capital market; even national currency bonds in some cases.

Commercial Global Foreign Direct Investment (FDI) was worth $1.54 trillion in 2019; of which $45 billion (=2.9%) was invested in Africa.[10]

The diaspora's financial transfers increasingly cover developing countries' need for external financing and hard currency. Transfers to the 54 member countries categorised by the IMF as "Low-Income Developing Country, LIDC" (GDP less than $2,700 per capita in 2016) rose from $10 billion in 2000 to $80 billion in 2016, while development assistance defined as ODA increased from $10 billion to $30 billion.[11]

Private philanthropy is a source of funding for niche projects such as the fight against AIDS. In the 2016-2019 period, donations from 205 researched funds delivered 10.6 billion USdollar on an annual average; 13% of the amount went to the poorest countries.[12]

Mission creep in Western development finance from the 1990s onwards

The increased mobilisation of private capital led Western donors in the 1990s and 2000s to reduce the proportion of aid going to 'hard investments' in physical infrastructure and instead increase the proportion of aid going to the 'soft sectors' of health, education and alleviation of extreme poverty; that is, to provide 'national public goods'. Within the framework of the OECD Development Assistance Committee (DAC), donors agreed to eliminate "tied aid" that bound goods and services financed by foreign aid to supplies from the donor country; and promised in the 2005 Paris Declaration to coordinate their aid programmes and give the beneficiary countries a greater say in their content.[13]

At the same time, a 'global good' theme entered the international development agenda: the pressure on the global environment and the resulting demands for "sustainable development". The World Commission on Environment and Development (WCED), set up in 1983, published in 1987 the report "Our common future" (known as the Brundtland Report). It states that global environmental problems are due to overuse of resources in the North ("non-sustainable" consumption and production patterns) and extreme poverty in the South. This led to the adoption of two conventions

[8] In 2022, the upper limit for access to IDA loans is a GDP per capita of USD 1,205.
[9] The interest rate on IBRD loans covers the price of bonds that the World Bank sells on the capital market, plus the bank's general administrative costs plus a small profit used for partial subsidization of IDA loans
[10] Source: UNCTAD: "World Investment Report 2020".
[11] The amounts do not include the numbers for Nigeria. IMF: "Macroeconomic developments and prospects prospects in low-income developing countries", 2019.
[12] OECD: "Private philanthropy for development – second edition. Data for Action". 2022
[13] The Paris-Declaration's five principles for development aid are: ownership, alignment, harmonisation, managing for results, mutual accountability. These were subsequently expanded in Accra.

at the United Nations Framework Convention on Climate Change (UNFCCC) held in Rio in 1992 to counteract global warming caused by greenhouse gas emissions and the Convention on Biological Diversity.

Environmental assistance became an important component of bilateral and multilateral development programmes, without in the 1990s leading to an expansion of international development aid. Denmark was an exception: for a short period, aid was almost twice the normal 0.7% level of GDP. In 1992, development aid reached 1% of GDP. On top of that came in 1993 funding from the new MIKA (Environment and Disaster) programme, jointly administered by the Ministry of the Environment and the Ministry of Foreign Affairs, which in 1998 was renamed MIFRESTA (Environment, Peace and Stabilisation) with an annual budget decided to increase gradually to 0.5% of GDP by 2005. MIFRESTA was abolished in 2003. However, the concept of additional assistance for environment returned in 2009 at the COP-15 meeting in Copenhagen, when developed countries promised to provide "additional climate finance" of $100 billion annually by 2021.

Promotion of women's equality became an important ‘cross-cutting consideration’ in the approval and implementation of aid projects. In the 2000s, the concept of applying a “human rights-based” approach to poverty eradication and development spread in Western development aid. Democracy programmes seek to promote knowledge of fundamental democratic rights and principles, provide support to civil society organisations and strengthen the country's legal systems, combat problems of widespread corruption through assistance to good governance and assist national parliaments with the improvement of their administrative systems and procedures. While the World Bank's Statute instructs the Bank not to take a position on the internal political affairs of client countries, the European Bank for Reconstruction and Development (EBRD) was established in 1991 with the explicit mandate formulated in Article 1 to operate in countries that "commit themselves to and apply the principles of multiparty democracy, pluralism and market economy".[14] Some Western countries even engaged in military action in Iraq, Libya and Afghanistan to force 'regime change' from authoritarian to democratic rule.

‘Mission-creep’ – that more and more purposes must be taken into account in development aid – accelerated after 2000. In 2000, the UN adopted eight Millennium Development Goals for 2015; three concerned health, the other the fight against poverty, women's equality, education, the environment, the promotion of global partnerships for development.[15] In 2015, the UN adopted the 2030 Development Goals with the resolution " Transforming our world - the 2030 Agenda for Sustainable Development". It refers to "sustainable development" as consisting of three dimensions: an economic, a social and an environmental one and, accordingly, presents a broad field of action with 17 development objectives and 169 sub-objectives.[16] The goals are to be achieved in a "Global

[14] This led the EBRD to e.g. suspend all sovereign operations in Uzbekistan after the brutal government crackdown on political opposition in 2005.

[15] Eradicate extreme poverty and hunger. Achieve universal primary education. Promote gender equality and empower women. Reduce child mortality. Improve maternal health. Combat HIV/AIDS, malaria and other diseases. Ensure environmental sustainability. Develop a global partnership for development.

[16] No poverty. Zero hunger. Good health and well-being. Quality education. Gender equality. Clean water and sanitation. Affordable and clean energy. Decent work and economic growth. Industry Innovation and infrastructure. Reduced inequalities. Sustainable cities and communities. Responsible consumption and

Partnership for Sustainable Development", where "each country has primary responsibility for its own economic and social development" but "public funding, both national and international, will play a vital role in providing essential services and public goods and catalyzing other sources of funding."

On the heels of the 2015 migration crisis that hit several EU countries, then-German Chancellor Angela Merkel suggested that the EU launch a Marshall-Aid like plan for Africa to eliminate the root cause of migration. It is a misunderstanding in some political circles that absolute poverty drives South-North migration; that it is a causal factor for internal displacements and South-South cross-border migration. Poor people earning less than $2 a day cannot afford to pay people smugglers $5,000-15,000; only middle-class families can raise such sums. South-North migration is driven by relative poverty, by the huge differences in GDP per capita in the EU and in low-income countries. The combination of high population growth and slightly rising incomes increases the number of middle-class families actively seeking migration. Equally naïve is the expectation of some EU Governments that reduced access to development aid can pressure governments to repatriate citizens who have regularly emigrated to the EU.[17] Remittances, including from irregular migration, are far too important for their economies and their population would react violently against what it would see as racist pressure. It makes sense that DAC countries include spending on refugees outside the EU and on irregular migrants within the EU in the annual foreign aid inventory. However, negotiations on the repatriation of irregular migrants should only be conducted in the context of agreements to facilitate regular migration.

The entry of China in development finance from 2000 onwards

The world's belief in the superiority of the Western system was undermined by the financial crisis of 2007-2009 and by communist China's economic growth raising its share of world GDP from 2% in 1980 to 19% in 2019.[18] China's ability to lift hundreds of millions of its inhabitants out of deep poverty over 20 years showed the world that there was an alternative effective development paradigm: state-driven growth led by an authoritarian regime. China's ability to influence was further enhanced by its increasing impact on the economic situation of developing countries. China's rapidly growing demand for imported raw materials, which from the year 2000 drove up international commodity prices sharply[19], triggered a commodity boom driving growth in many developing countries. The explosive increase in imports of goods from China[20] was accompanied by Chinese contractors working or settling locally.[21]

The adoption by the People's Congress of the "going out"/"going global" initiative in 2000 led to a dramatic expansion of China's lending to developing countries. An important economic purpose of

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production. Climate action. Life below water. Life on land. Peace, justice and strong institutions. Partnerships for the goals.

[17] The Danish development strategy "Common about the World" adopted in 2021 states "As a starting point we will not give long-term development assistance to states that refuse to accept their own nationals".

[18] https://www.silkroadbriefing.com/news/2019/07/04/us-1-billion-belt-road-africa-fund-launched

[19] The oil price per barrel rose from $20 (expressed in real terms 2021 prices) in 2000 to an all-time high of $156 in 2008. Source: Historical Oil Prices Chart (inflationdata.com)

[20] In the 1980s, China's trade with Africa amounted to $10 million per year, in 2006 it reached $55 billion.

[21] The number of Chinese settlers in Africa is estimated at 1 million in 2018, plus just over 200,000 workers. An estimated 200,000 Africans work in China. Source: https:// en.wikipedia.org/wiki/Africa-China_relations

China's development funding is to strengthen the globalisation of Chinese companies. The political objective is to change the international governance structure for development aid and break its Western dominance. The policy received a practical expression in 2013 with the adoption of the Road and Belt initiative, the ambition of which is to create six economic corridors to connect up to 65 countries more closely with China's economy. In 2014, the Silk Road Fund was set up with a capital of $40bn.

The slogan for China's development cooperation is the implementation of "mutually beneficial projects" to build a "global community of shared future". The idea is that inadequate infrastructure is blocking economic growth in the partner countries and that, by remedying shortcomings in these, mutual benefits in terms of increased trade are created.[22] China funds major infrastructure projects, especially in transport (railways, ports, airports, highways) and in energy, as well as investments in oil and mining. Financing is offered without being made conditional on internal reforms, and the approval and implementation of projects takes place faster than usual when loans are approved by international development banks. Construction contracts are given to Chinese companies.

Economic infrastructure projects are financed by the China Development Bank and by the major state-owned commercial banks: Industrial and Commercial Bank of China, China Construction Bank, Bank of China, Agricultural Bank of China, as well as by individual non-state-owned banks. The loans are non-concessional, i.e. close to the conditions of the private capital market, and require solid collateral. For example, in the form of a mortgage on the financed infrastructure (port in Sri Lanka, power grid in Laos); by placing future revenues from the funded project in an "escrow account" from which money is drawn first for loan repayments before any other purposes can be funded (Uganda Airport), by collateral in the revenues of the country's oil exports (Angola and Venezuela). From 2008 and 2019, the China Development Bank and Export-Import Bank of China lent 462 billion USdollar; which matched the World Bank's 467 billion USdollar during the period.[23]

Chinese development aid in a form similar to ODA (Overseas Development Assistance) is of modest scale, never reaching more than $3bn during the 2003-2019 period.[24] China International Development Cooperation Agency (CIDCA) established in 2018 manages the grant and interest-free loans, export-import bank of China the concessional loans. Grants are used to finance technical assistance, welfare projects and humanitarian aid; interest-free loans are given for the construction of public facilities, concessional loans finance economic and infrastructure projects.[25] Both types of loans are granted only against sovereign guarantee.

China attacked the Western institutional dominance directly in 2015 with the creation of two multinational development banks: the Asian Infrastructure Investment Bank (AIIC), based in Beijing, which at present has 105 members, and, the New Development Bank (NDB) based in Shanghai, which has the other BRICS countries Brazil, India, Russia and South Afrika as co-owners.[26]

[22] Estimates of the impact on trade, economic growth and foreign direct investment can be found in the report ”Belt and Road Economics. Opportunities and Risks of Transport Corridors”. World Bank. 2019

[23] Source: China pulls back from the world: rethinking Xi’s ‘project of the century’, FT 12.12.2020

[24] China Africa Research Initiative: “Chinese Global Foreign Aid” (sais-cari.org)

[25] State Council of the PRC: “White paper on China’s international development cooperation”. 2021

[26] Bangladesh, United Arab Emirates (UAE), Uruguay and Egypt joined the bank in 2020.

China succeeded in breaking the western world's dominant position in international economic cooperation. In 2018, more African leaders attended the Forum on China-Africa Cooperation (FORAC) meeting in Beijing than at the UN Annual General Assembly two weeks later.[27]

Challenges faced by the Chinese approach to development finance: need for rethink

The Chinese model's focus on large commercial loans for infrastructure projects, which are approved quickly and without conditions for the implementation of economic reforms, was so popular on the loan taker side, that China upended the international structure for the financing of sovereign loans. While low-income countries[28] owed three quarters of their $65 billion debt to Paris-Club countries in 2006; they owed more than half of the $200 billion debt to China and just under a third to Paris-Club countries by 2021.[29] The rapid growth in lending from China caused the public debt of the low-income countries to move up from 33% of their GDP in 2013 to 48% in 2021, thereby eroding their debt repayment ability. By 2021, 55% of low-income countries were in debt distress, or exhibited "high risk of debt distress," compared to just 23% in 2013.[30] China therefore joined the debt relief initiatives of the G-20 cooperation in 2020 and 2021, although very tentatively.

The debt situation weakens China's soft power propaganda, which recommends the country's development model as inspiration for application in other countries. China's growth model used a domestic savings ratio of over 40% of GDP to finance huge investments in both infrastructure and in building an internationally competitive manufacturing industry. The savings ratio of the low-income countries was and is less than half the rate and their ability to repay foreign borrowing was and is limited by the absence of the internationally competitive industry component - high-productivity sectors are typically found in the mining sector as low-employment enclave economies.[31] In particular, countries which, unlike Angola and Zaire, do not have large oil and mineral deposits, experienced large trade deficits. In 2015, Kenya imported $5.9 bn in goods from China (much of it for materials for the Mombassa-Nairobi railway) and exported $99 million in goods. Africa's large trade deficit with China - $46 bn in 2016 - prompts African governments to react and demand that China makes active efforts to develop imports from Africa. One request is investment in the creation of companies that can act as subcontractors for Chinese manufacturers.

China has begun to adapt its funding to the fragile debt capacity of its loan-recipients. At the Belt and Road Forum for International Cooperation held in Beijing in 2017, President Xi Jinping called it the project of the century and talked about an investment volume of over $1 trillion which China was willing to fund. But in both 2020 and 2021, China's Belt&Road funding of $60 billion, was 48% below 2019 levels.[32] The three-year cooperation budget of 40 billion USdollar presented by China at

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[27] More African presidents went to China's Africa forum than UN general assembly — Quartz Africa (qz.com)

[28] The 69 countries in Africa, Asia and South Africa that have access to loans from the IMF's interest-free Poverty Reduction and Growth Trust (PRGT).

[29] Kristalina Georgieva and Ceyla Pazarbasioglu:" The G20 Common Framework for Debt Treatments Must Be Stepped Up" IMF Blog 02.12.2021

[30] IMF Policy Paper:"Macroeconomic Developments and Prospects In Low-Income Countries-2021. March 2021

[31] Professor Dani Rodrik's lecture "The Future of Growth in Developing Countries" on Youtube highlights how important employment in industry is for a country's take-off; and how difficult it is for Sub-Saharan Africa to follow this path.

[32] Christoph Nedopil Wang: "BRI Investment Report 2021", Green Finance Development Center, Fuhan University. 2022

the 2021 Forum on China-Africa Cooperation (FOCAC) meeting was a third less than the $60 billion pledges made at FOCAC meetings in 2015 and in 2018.

China has also become more aware of the need to avoid problems of corruption[33], of funding white elephants[34] and of causing environmental damage. Increasing environmental awareness within China and negative public reactions to environmental problems created by Chinese projects abroad led the Ministry of Commerce (MOFCOM) and Ministry of Ecology and Environment (MEE) to issue "Guidelines for Greening Overseas Investment and Cooperation" in 2020 and "Guidelines for Ecological Environmental Protection of Foreign Investment Cooperation and Construction Projects" in 2022.

In China's "ODA"-type assistance, soft topics and support for global goods are being given greater weight: At FORAC 2021, poverty alleviation (technical assistance for smallholder production) received more funding and China pledged to donate 1 billion doses of corona vaccines to Africa.

<u>Challenges faced by the Western approach to development finance: need for rethink</u>

The OECD/DAC countries' aid concept, characterised by a high proportion of grants and a broad field of objectives and of interventions, also faces pressures for change. China's funding for costly infrastructure has given China's aid a higher visibility and popularity than Western donors' funding for budget support and small soft projects.[35] Chinese technical standards becoming dominant in sectors such as railways and digitalisation is a cause for concern for the West. Therefore, funding for large infrastructure projects is back on the DAC countries' priority list. In June 2021, the US launched the Build Back Better World (B3W) initiative, an infrastructure partnership to mobile public and private capital for investments in climate, health and digital technology. . In December 2021, the European Commission launched the Global Gateway Initiative, which promises to mobilise up to €300 billion by 2027 for projects in green and digital transformation in the partner countries. The initiatives emulate the Belt&Road concept insofar as they concern the financing of large projects which promote trade and transnational cooperation between the involved countries.

The paternalism of DAC countries in aid cooperation is facing increasing resistance. The excessive use of Western consultants in the preparation and implementation of projects is a diminishing problem, as the quality of local expertise is gaining increasing recognition. However, despite years of rhetoric about programming development assistance in partnership between donor and recipient, the interests of donors continue to play an overly dominant role in the selection of cooperation themes. African commentators criticise the fact that the EU Global Gateway initiative was launched without previous consultation with African leaders; whereas China held consultation meetings for

[33] Dr Mahathir, Malaysia's Prime Minister, renegotiated in 2018 loan terms entered into by his corrupt predecessor Najib Razak, cancelling both the $20bn expensive East Coast Rail Link belt-and-road project and two oil pipelines in Sabah province.

[34] In 2014, a motorway project in Montenegro, which the EIB refused to finance as non-economic, received a €944 million loan from the Export-Import Bank of China. The project ran out of money before the completion of the construction. Montenegro has payment problems and tried to get the EU to take over the loan, which was rejected.

[35] According to Afrobarometer: "Africans' perceptions about China: A sneak peek from 18 countries" 3 September 2020, 59% of respondents believed that China's political and economic influence was predominantly predominant, while only 46% of respondents thought the same about the assistance of the former colonial powers.

several months ahead of the Forum on China-Africa Cooperation in 2021.[36] Lecturing from DAC countries backfires. Although EU countries provided 46% of total ODA aid to Africa, and Africa's trade in goods with EU countries worth €235 bn was almost double their €125 bn trade with China[37,] some African voices criticize that "China provides bridges, the EU provides admonishing lectures".

The paternalism of the DAC countries is rife with double standards. At the COP-26 meeting in Glasgow, 20 Western countries adopted a declaration to stop using public funds to fund "unabated fossil-fuel projects" abroad. The policy argument is that developing countries by leapfrogging into renewable energy can avoid repeating the failure which the developed countries made by locking themselves into a fossil-fuel based energy structure with long economic lifetimes. Meanwhile, donors continue to approve fossil-fuel using energy projects in their own countries. In 2022, the European Commission included natural gas in its "green energy taxonomy" list.

The 1992 Rio Conference Declaration on Environment and Development states in Principle 7: In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities". Whereas there is agreement that rich countries and poor countries have "differentiated responsibilities" in climate cooperation, the extent of the rich countries' responsibility is a contentious issue.

First of all, so far, the rich OECD countries have not lived up to their responsibility. The $100 bio per year pledge in additional climate finance to be reached by 2020 was $20 bio short of that goal in 2019[38]. How much of that money was additional is open to interpretation. Only a fraction of that finance has so far been channeled to the 'NAMAs (Nationally Appropriate Mitigation Action)' and 'NAPAs (National Adaptation Programme of Action)' which developing countries prepare in order to attract climate finance.

Secondly, a number of developing countries backed by NGOs introduced the subject of 'climate loss and damages' into the funding debate, insisting that rich countries pay the poorest countries compensation for the losses and damage that climate change inflicts on them. In the 2015 Paris Agreement, rich countries promised to "address the losses and damage caused by the harmful effects of climate change". The purpose of the change from "address" to "compensate" is probably to get around the limited political 'willingness to pay' of rich countries by making the legal-economic 'polluter pays' principle the foundation for finance discussions. In the end, this would lead to the volume of 'climate loss and damages' funding be determined by court decisions.[39] The compensation claim is problematic operationally[40] , legally[41] and conceptually. Its underlying cost-

[36] Faten Aggad of Algeria, previous advisor to the African Union's high representative on Africa-EU negotiations quoted in Chloé Farand: "As EU seeks to rival China's infrastructure offer, Africans are skeptical". Climate Home News 20. dec. 2021

[37] Explainer: "Towards a Comprehensive Strategy with Africa".- Modern Diplomacy March 12, 2020

[38] In 2019, climate finance for developing countries was USD 79.6 billion in 2019, an increase of 2% from 2018. Source: "Climate finance provided and mobilised by developed countries". OECD 2021

[39] Climate activists in the Netherlands have filed a lawsuit against Shell demanding that Shell pays compensation for the climate damage that is caused by Shell's historic oil and gas production .

[40] One example: How do you determine that a storm which inflicted damage in a region was caused by changes in the weather due to climate change? Storms have been around for as long as the earth has had an atmosphere

[41] Kuwait has become rich in producing and exporting oil, which in consumption has led to CO2 emissions. Climate change will boost the already high temperatures in Kuwait to over 50 degrees Celsius for several

benefit calculation is partial in that it incorporates only the negative CO_2 externality of past fossil energy consumption and overlooks its positive externality: the gigantic technological developments of the last 150 years, which all countries benefit from and for which fossil energy consumption was a prerequisite. The rich countries' past CO2 emissions were an investment in global progress which created the present distribution of wealth but also imposes great global costs for climate adaptation and for repairing climate damage. The large bill for that must be divided according to the differences in ability to pay, which was created by the investment.

The paternalism of DAC donors finds its strongest expression in the misconception that external assistance provided by diverse democracy programmes can trigger structural change towards more democracy and respect for human rights in recipient countries. The results of 30 years of active action can be seen in the annual democracy index published by the Economic Intelligence Unit (EIU) by the Economist. The index score summarises the assessment of the situation in five areas: electoral process and pluralism, civil liberties, government function, political participation and political culture. Under the unipolar world order of the 1990s and early 2000s, the number of countries classified to some extent as having a democratic form of government increased. Beginning in 2010, the trend reversed. In 2020 the index fell to its lowest level since the start of the 2006 polls. The ambitious attempts at regime change through military intervention suffered a crank fate in Afghanistan, Iraq and Libya. Bosnia-Herzegovina's constitution and political structure, introduced with massive external expertise, are a recipe for the creation of a 'failed state'. The institution of a UN High Representative for Bosnia and Herzegovina with authority to adopt and repeal laws was established to support the reconstruction of Bosnia and Herzegovina. It is still in place 27 years after the conclusion of the Dayton Agreement.

Much more meaningful are capacity-building ‘bottom-up’ activities at grassroot level: building the capacity of local civil society organisations to act as advocates for marginalised groups, promoting the role of women as economic and political actors and improving two-sided communication and interaction between local authorities and citizens. However, it depends on the goodwill of local politicians and elites whether the capacity-building of civil society leads to real improvements in the country's political-social-economic decision-making processes. The elite will only listen to the voices of civil society if it serves their interests, while public support for newly created democratic institutions depends on citizens being able to see improvements in their economic and social situation. The people of Afghanistan in 2004 and Iraq in 2005 flocked enthusiastically to the ballot box because they believed that by allowing their voices to be heard they could promote economic and social progress; in the 2019 elections, turnout was below 50%. Evaluations of Danida's democracy and human rights efforts are laudatory, but have difficulty documenting impact. Human rights are an elastic concept under constant expansion. Attention to the satisfaction of new identified rights make human rights a foreign aid forever candidate. It is questionable whether sending experts is cost-effective when intelligent use of the Internet makes it an excellent instrument for the worldwide exchange of information, ideas and insights. Going forward, it makes

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months of the year within a decade or two. Does Kuwait's oil production oblige the country to pay compensation? Or does the temperature rise make the country eligible for compensation?

sense to direct donor efforts towards improving the internet instrument, of which the Tech for Democracy Initiative by the Danish Ministry of Foreign Affairs is a promising example.[42]

What can be said about the relevance of Bauer's critique 50 years later

In light of the dynamic evolvement and changes in development aid over time, what can be said about the relevancy and appropriateness of Bauer's "foreign aid forever" critique 50 years later?

Bauer's views have obvious weaknesses. If a newborn nation lacks basic institutional and physical infrastructure, then it is obvious that a well-executed foreign aid can facilitate the development of 'mainsprings of progress'. Bauer was also blind to the spontaneous market-driven development's dependence on geographical location. Sub-Saharan Africa's development is handicapped by unfavorable geography[43] and at the beginning of independence in 1960 of a small population of 229 million spread over a vast area. By contrast, Singapore's development into one of the world's richest and most technologically advanced countries was favoured by its position as a trading and maritime hub for emerging economies in East and Southeast Asia.

Other of Bauer's views and predictions have proven to be more relevant.

First of all, unlike Marshall Aid, foreign aid has not become a short-term parenthesis in the history of the world. In 2020, the level of ODA set a new record in absolute terms to the tune of US$161 billion[44] ; net transfer (after deduction for repayments on previous loans) was US$117 billion.[45] As a percentage of donors' GDP, the picture is less flattering. The DAC's annual report shows a fall from 0.55% of GNI in 1960 to 0.35% in 1970, in the 1990s a decline to 0.25% and after 2000 an increase to around 0.30%.[46] Only four countries - Luxembourg, Norway, Sweden, Denmark - meet the 0.7% target; the first three with about 1% of GDP, Denmark with 0.7% of GDP.

Secondly, the greatest economic progress happened in countries where development aid made a modest contribution to the state budget: China and South-East Asia.[47] Sub-Saharan Africa received the largest contributions as a percentage of their state budgets (25-60%) and as a percentage of GDP (10%)[48]. Progress was solid in a range of areas. From 1970 to 2013, access to higher education increased by 4.3% per year (global average 2.8%)[49]; average life expectancy increased from 47 to 64 years[50], the proportion of Africans living in extreme poverty fell from 54% in 1990 to 41% in 2015.[51] The countries, with the exception of the so-called 'fragile states', now have highly competent

[42] Find information about the program at www.techfordemocracy.dk. See videos with the presentations from The International Conference Tech for Democracy, 18 November 2021.
[43] Convincingly described by Jared Diamond in "Guns, Germs and Steel," 1998
[44] COVID-19 spending helped to lift foreign aid to an all-time high in 2020 but more effort needed - OECD
[45] World Bank: "International Debt Statistics 2022 report".
[46] The development is shown in a chart at Official development assistance - Wikipedia
[47] One exception is South Korea, which from 1948 to 1975 received massive and sustained assistance from the United States and in the later part of the period from Japan.
[48] During the 1970 to 2012 period, the share fluctuated between a low 7% of GDP in 1971 and a high 20% i 1994. Source: Lauren Tait, Abu Siddique and Ishita Chatterje: «Foreign Aid and Economic Growth in Sub-Saharan Africa" University of Western Australia., March 2016.
[49] Figures of the Week: Higher education enrollment grows in sub-Saharan Africa along with disparities in enrollment by income (brookings.edu)
[50] Africa: life expectancy 1950-2020 | Statista
[51] World Bank:"Accelerating Poverty Reduction in Africa", October 2019

officials, engineers, financial experts. This reduces the need for assistance from foreign experts to the provision of highly specialised inputs. Access to the Internet also assists in leveling access to information and to knowledge.

Yet, despite significant progress in institution and capacity building, the gap between the GDP per capita of EU countries and Africa widened. Measured in 2019 fixed prices, Denmark had in 1960 a GDP per capita of $3,464, which was 14 times greater than Ghana's of $254 and 19 times greater than Tanzania's of $180. By 2020, Danish GDP per capita of $60,909 was 26 times larger than Ghana's $2,329 and 57 times greater than Tanzania's $1,076.[52] Although the average economic growth rate of African countries over the period was higher than the Danish rate of 2.3% - Ghana's was 3.7% and Kenya's at 4.7%[53], the high African population growth in sub-Saharan Africa (to over 1 billion people in 2018) increased the difference in income per capita.[54] Population growth is encouraged by poverty, by a low level of education of women and by African politicians who believe that a large population promotes a country's international weight. The average median age of 19.7 years in African countries (EU = 42.5 years) provides the high dependency ratio[55] of 1.23 (EU = 0.65). Before growth can really accelerate, the dependency ratio must go down.[56] Looked at the development from a positive angle, it should be noted that Ghana's per capita income over the period has increased from 7% to 67% of the Danish level in 1960.

The uneven development during the last 50 years kept alive academic and political debates about the contribution of foreign aid to economic growth. At micro-level, economists agree that most development projects yield a positive return. The controversy is at macro-level: whether it is feasible to document positive impacts of development aid on the economic growth of the recipient countries? Nobel laureate Angus Deaton denies that foreign aid promotes economic growth[57], while Paul Collier insists it has lifted the growth rate to the poorest billion people over the past 30 years.[58] At times there was not even a 'Washington consensus' about the issue. A World Bank research report in 1998 concluded that aid has a positive impact on economic growth provided that the country pursued the right policy.[59] In two research papers from 2005, the IMF could not demonstrate such an influence.[60] International studies looking at individual sectors, that received aid finance, conclude that aid for social infrastructure, especially education and health, and general budget support, have a significant positive effect on economic growth.

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[52] https://www.macrotrends.net/countries

[53] https://www.theglobaleconomy.com

[54] World bank Population Estimates and Projections database

[55] The ratio of "population younger than 20 or older than 64 years"" to "population from 21 to 64 years". Source: "Africa's high birth rate is keeping the continent poor" Economist 22.09.2018

[56] East Asia's economic take-off from the 1970s came after a sharp drop in fertility rates. Source: David Philing "Africa's population boom doesn't spell a demographic dividend". FT 26.12.2021

[57] Angus Deaton, his Nobel Prize, and foreign aid (brookings.edu)

[58] Michael Clemens, Steven Radelet and Rikhil Bhavnani: "The short term effect of aid on growth". Center for Global Development. Working Paper Number 44 July 2004

[59] "Assessing aid: what works and what doesn't", World Bank Policy Research Report November 1998

[60] Nadia Masud and Boriana Yontcheva: "Does Foreign Aid Reduce Poverty? Empirical Evidence from Nongovernmental and Bilateral Aid." IMF working paper 2005/100. Raghuram G. Rajan and Arvind Subramanian: "Aid and Growth: What Does the Cross-Country Evidence Really Show? IMF working paper 2005/127

Danish academia also lacked consensus. Aarhus economists Martin Paldam and Christian Bjørnskov note in their studies that the effect is positive and small.[61] According to Henrik Hansen and Finn Tarp from the University of Copenhagen, an aid of 10% of GDP raises the country's annual growth rate per capita by more than 1 percentage point in the long term. Tarp criticizes, as also other researchers do, that the detection of small effect is due to too short a time horizon in the analysis (typically four years). A time horizon of 10 years or longer gives a more correct and positive view. [62]

Because of continued existence of deep poverty and backwardness, criticism reminiscent of Bauer's views can be heard on the recipient side. Zambian economist Dambisa Moyo stated in her 2009 book "Dead aid" that aid does not work. Her main argument is that to justify its position, a national government must be able to deliver "public goods", such as- education and health, on its own; it is its job as ruler. Foreign co-financing of "public goods" leads to a lack of transparency/accountability for the result which promotes corruption. Moyo recommends that all economic development aid for public goods be scaled back over a five-year period. At a press conference with French President Emmanuel Macro in 2017, Ghana's President Nana Akufo-Addo called on African countries to 'free themselves from foreign aid because it has never worked and never will'.[63]

The claim that aid had an insignificant impact on the investment and growth rates of the recipient countries, is not credible, large financial inflows have Keynesian expansionary impacts and capacity building assistance raises productivity. Zero impact presupposes that major distortions in the allocation of funds counter-balance the expansionary impact of funding. For example,: that projects are decided by donors and not by the real needs of the beneficiary countries; that donor funding eliminates the need for those in power to collect taxes; that the influx of large amounts of donor money into the economy has negative 'Dutch disease' effects in the form of an overvalued national currency which stifle exports; etc..

Recommendations for adapting DAC assistance to today's key challenges

An adjustment of development aid by DAC countries must take position on two macro issues.

The first is the concept of 'joint responsibility for achieving the 2030 development objectives'. Does it create the right division of labour for the use of national and international public funding? Or, does joint funding of 'national public goods', as argued by Damisa Moyo, remove transparency about the government's responsibility for providing these and postpone the introduction of revenue raising reforms to finance them?[64] International co-financing of 'national public goods' in the name of solidarity, founded in the large international differences in per capita income, means a continuation of development cooperation within a paternalistic donor-client relationship.

[61] Christian Bjørnskov: "Types of Foreign Aid", Economics Working Papers 2013-08. Hristos Doucouliagos and Martin Paldam: "Finally a breakthrough? The recent rise in the size of the estimates of aid effectiveness", Economics Working Papers 2014-07

[62] Channing Arndt, Sam Jones, and Finn Tarp: Aid, Growth, and Development. Have We Come Full Circle? UN-WIDER Working Paper No. 2010/96

[63] Ghana's president surprised Macron with aid rejection | FairPlane

[64] The median tax revenues in percent of GDP of the 54 Low Income Developing Countries were 13% of GDP in 2013 and also in 2019 despite technical assistance for their increase. Source: IMF Annual reports

The other macro-issue is the impact of mission creep on the effectiveness of development aid. One consequence is less clarity about what donors consider important and less important in aid.[65] Another is institutional fragmentation. From 2000 to 2019, the number of institutions channeling official aid to developing countries increased from 191 to 502 and the number of countries and multilateral institutions providing official funding from 47 to 70[66]. Is institutional fragmentation a response to the fact that addressing the challenges of a more complex globalised world requires more specialised institutions? Or, is fragmentation a consequence of donors attempting to cover too many issues? One indication to suggest the latter is that donors during the last twenty years have reduced the number of staff in their aid administration and replaced technical experts with generalists.

It is reasonable to assume that international development cooperation can become a more effective response to the global challenges of our time by leaving the financing of 'national public goods' 100% to the national governments of the beneficiary countries, and concentrate development finance on three topics:

1. Production of 'global goods' (climate mitigation and adaptation, biodiversity, regional environmental pollution, cross-border transport and supply lines; digitalisation, combating pandemics; UN peacekeeping efforts under UN/regional auspices).
2. Creating a more level playing field for entrepreneurs in developing countries in the domestic and international markets (reduction in interest rate differentials between North and South; improved access to information on state-of-the-art technology and the identification of the most suitable partners in international supply chains).
3. Humanitarian aid (food crises, refugee aid, disaster relief).

The focus on the three topics establishes a partnership of equals between donors and recipients of aid money in international development cooperation. To describe cooperation about investments in 'global goods' as development aid is a misnomer. The appropriate term is "development finance".

Democratic and transparent processes are created, in this cooperation, on the ground through clear guidelines that aid projects independent of sector must take maximum account of gender, protection of the legitimate interests of minorities, and the involvement of citizens and civil society organizations in the identification, design, and implementation of projects. Governance best practice is spread through the organisational structure that will be set up for co-financing projects in individual countries and regionally.

As climate finance becomes a key element of cooperation, there is no longer a need for separate 'additional climate finance' calculations. But the proposed reorientation towards the financing of 'global goods' in climate, transport, communications and digitalisation requires 'additional development finance'. The need for public finance support for these capital-intensive investments is so great that it exceeds the savings from removing the financing of 'national public goods'. The self-interest of rich countries in the implementation of 'global good' projects should be a strong political

[65] "World in 2030 Denmark's development policy and humanitarian strategy" from 2017 mentioned which of the 17 Sustainable Development Goals were important for the strategy. The new strategy adopted in 2021 "Common about the World" has no explicit priorities.

[66] Akihiko Nishio and Gaiv Tata: "How the structure of global aid and development finance is changing". November 3, 2021. www.brookings.edu

argument for gradually raising DAC countries' average annual development funding from the current 0.32% to 0.7% of GNI.

The ‘climate loss and damage’ compensation discussion is confrontationally and risks blocking the spirit of cooperation needed to combat climate change. The objective issue of the limited capacity of low-income countries to shoulder the burden of climate loss and damages must be dealt with pragmatism. Money from disaster relief can be used to assists low-income countries to repair damages caused by severe weather conditions; while investments financed by climate adaptation money reduce future ‘climate loss and damages’ in low-income countries. In order to apply this approach, the present composition of international climate finance must be reversed in accordance with the wishes of low-income countries.[67] According to OECD’s statistics on ‘additional climate finance’, the adaptation finance of $20.1 billion in 2019 amounted to 25% of the total climate finance of $79.6 billion; while the share of public grant finance ($16.7 billion) in ‘additional climate finance’ was 21%. Adaptation investments need substantial grant finance, because - unlike mitigation investments in green energy and in energy savings – they do not generate money from new revenue or operational cost savings which can be used to repay loans.

The large investments in ‘global goods’ create an important market in low-income countries for new and advanced technology. The active participation of national contractors and investors in this market increases national value creation. The tool of local content requirements in public procurement must be supplemented by green business and technology policy initiatives. The creation of links between international funding of projects and local business development activities must be an important performance parameter for North-South cooperation on ‘global goods’. Kenneth Rogoff's proposal “to create a new, focused agency, a World Carbon Bank, that provides a vehicle for advanced economies to coordinate aid and technical transfer, and that is not simultaneously trying to solve every other development problem”[68] deserves to be given prompt and considerable attention.

Investments in ‘global goods’ are capital intensive. High interest rates in low-income countries are an obstacle in the transition towards a low-carbon economy, because they reduce the financial attractiveness of green investments and the ability of local entrepreneurs and investors to gain market shares. Creating greater equality between financing conditions in DAC and low-income countries requires the use of radically new finance tools.

One structural adjustment task is to enable low-income countries (most of which have no or investment grade credit ratings or are barred from new borrowing by their already high debt levels) to sell sovereign green bonds on the international capital market at terms roughly equivalent to those enjoyed by government bonds from DAC countries. Jeffrey Sachs illustrates the great advantage that the United States and EU countries have in that their central banks can always buy up their own internationally used currency: interest rates on government bonds from highly

[67] Read Group of Like Minded Developing Countries and the African Group of Negotiators. Decision XX/CMA.4: COP-26

[68] Kenneth Rogoff: “It's high time to create a World Carbon Bank”, The Guardian 8.7.2019

indebted Italy are significantly lower than for government bonds issued by low-indebted Ghana.[69] This requires the introduction of international guarantees specifically for such bonds and the creation of a new financial back-up facility at the IMF.

Another structural financial sector adjustment task is to increase the share of local private capital in 'global goods' finance. Higher local co-finance of these investments increases the national value creation from these. DAC countries have for more than two decades made use of public finance instruments to leverage private finance from DAC countries for investments in emerging and low-income countries. In tenders or auctions for the implementation of Greenfield renewable energy projects, private investors from DAC countries already enjoy a competitive advantage because of the low interest rates in DAC countries. The 'leverage subsidies', which are counted as ODA, reinforce the cost of capital disadvantage of competing project developers located in developing countries. It is time to get away from the one-eyed focus of public finance instruments on the mobilization of private capital from DAC-countries, and introduce specific 'leverage of local finance' support for investments in infrastructure. This will create a more level playing field.

[69] Jeffrey D. Sachs: "Time to Overhaul the Global Financial System". Project Syndicate Dec 3, 2021