Trends to 2005

It was clear by 2005 that three trends were shaping the aid industry. First, incomes had been rising rapidly in many developing countries over the previous few decades, especially in East Asia and India. Fewer countries were very poor.

Second, more developing countries were able to borrow from banks or bond markets at attractive terms. And much of the money flowing to developing countries was no longer government debt but private borrowing, equity and foreign direct investment, and even remittances from migrant workers.

Third, new players—official agencies and unofficial ones, usually called nongovernmental organizations (NGOs)—had been entering the market for aid, a market that had seen a century of entry by aid agencies and no exit (see Harford, Hadjimichael, and Klein 2004). The new entrants were not only of the traditional type—from new donors such as China, Slovenia, and Thailand—but also of entirely new types—agencies with different approaches to raising or disbursing funds. These new types included the Millennium Challenge Corporation, distributing most of its grants to countries meeting objective standards, and the Global Fund to Fight AIDS, Tuberculosis, and Malaria, focusing on a tight group of cross-border problems.

2005–10: political aid returns

During the 1990s there was reason to believe that the quality of aid was improving. By most measures aid from major donors was aimed more at countries with sound policies, while aid from the world’s largest donor, the United States, was focused more on poor countries in
2000 than 10 years earlier (see Harford and Klein 2004).

Looking back from 2030, it is obvious that the 1990s were a brief “golden age” between the end of the cold war and the start of the so-called war on terror. In the early 21st century aid again became for most donor countries largely a tool of foreign policy—a legitimate tool perhaps, but it was always evident that the result would be aid that was not necessarily aimed at the poorest or the best reformers, and aid delivered without much interest in evaluating development impact.

The repoliticization of aid was widespread, noted by the World Bank as a clear trend in 2004. At the same time new players were rising: fast-growing China and India, reemergent, oil-rich Russia, and smaller countries such as Slovenia and Thailand were all taking steps to establish their own aid agencies and aid systems in the early years of the century. (In 2030 China’s economy, with a per capita GDP of US$10,000, is clearly about to overtake the U.S. economy.)

The multilateral agencies were the most obvious victims of repoliticization: major donors withdrew support and resources in favor of their own programs. Why should donors fight political battles in the boardrooms of such institutions when they could retain complete control over their aid programs? What interest did the United States have in supporting specialized United Nations agencies? Why should Brazil, China, or India borrow from institutions whose voting structures were stacked against them when private money was available just as cheaply? Regional and international financial institutions found themselves operating under tight conditions. Bilateral aid, less carefully targeted at the poor and less focused on sound policy and institutions (see Harford and Klein 2004), grew in importance. Subcontracting and competition in the official aid industry withered, as governments wanted tight control of their aid programs and kept things in-house or relied on a few trusted contractors.

**People power takes up the slack**

But this shift was not a simple return to the politicization of the 1960s and 1970s, and competition and innovation were not dead. Big changes had occurred—in the attitude, resources, and awareness of ordinary people.

Many of these changes were already visible by 2005. For example, it was clear by then that remittances were going to be a critical competitor of official aid. They had been shown to be more stable (Ratha 2003) and a better prospect for boosting economic growth (Djankov, Montalvo, and Reynal-Querol 2004). These findings emphasized what should have been obvious: person-to-person transfers are likely to be well targeted and well spent. Between 1988 and 2001 remittances grew from less than half to twice official flows. Even in the poorest countries they exceeded official flows, and foreign direct investment as well.

Between 2000 and 2020, as the costs of wiring money home fell dramatically and international migration continued to increase, remittances grew even more important. A drop in average wiring costs from 13 percent to 3 percent between 2000 and 2010 saved US$10 billion annually—more than the disbursements of the International Development Association (IDA)—encouraging yet larger remittances (figure 1). Meanwhile the share of the world’s people working outside the country of their birth more than doubled, from 3 percent to nearly 8 percent by 2020, sucked in by the demographic deficit in rich countries and accommodated by policies that created different categories of guest workers—and even allowed the issuance of driver’s licenses for illegal immigrants, as seen in several U.S. states as early as 2003. By 2020 remittances had grown to nearly US$200 billion, dwarfing official aid flows.
More impersonal charity was also hugely important. Though still modest compared with official development assistance, annual grants from NGOs exceeded concessional loans from governments as early as 2002 and more than doubled to US$20 billion by 2010. Charities were simply getting better at fund-raising, in an environment where there was plenty of money around. Oxfam’s Christmas campaign in 2004 was one example: rather than giving Christmas presents, people flooded to the Oxfam Web site to buy chickens, school desks, even water tanks for an entire town (BBC Online 2004). Shortly afterward a huge public response to the Asian tsunami left governments scrambling to raise their own aid. In the United Kingdom private donations exceeded the government’s initial package within 48 hours (Reynolds 2004). By 2010 massive giving campaigns, often coordinated by religious organizations, were making these earlier private efforts look small by comparison.

2010–20: the “undergrowth”

Altruism, in the form of both remittances and charitable donations, was important. Yet altruism did not motivate most private flows. Even before 2000 it was becoming clear that private for-profit lending was posing serious competition to loans from governments and development banks. This lending was just the precursor to a huge variety of new ways for finance to flow to poor countries and especially to poor people. By 2005 Mexican mortgage companies were operating in the United States, offering mortgages to emigrants to build homes back in Mexico—a business model that was commonplace by 2015.

Even more important than the raw volumes of private financial flows was the innovation they provoked. A new generation of mutual funds arose with the aim of directing investment to profitable local projects in developing countries. They were fueled by growing retirement savings in rich countries, hungry for returns, and by an awareness that the most difficult operating environments presented the least competition. This trend was instrumental in raising standards of corporate governance (Klein and Harford 2004), increasing rewards to local expertise, and strengthening the business climate in poor countries.

Citizens of poor countries became far better connected, improving the effectiveness of aid, government spending, and private business. In 2004 a month of Internet use in Nigeria cost US$85, but Vietnam had already slashed costs to US$20. By 2010 Internet service was available almost anywhere on the planet for a few cents a month. By 2020 two-thirds of the world’s population had used a mobile phone. The easy access to information made it far simpler to tap into global best practices in health, agriculture, accounting, or food hygiene. Just as profoundly, it ensured that governments were held accountable. As early as 2001 the Ugandan school system had been transformed by the public dissemination of information about how much grant money each school was supposed to receive: the median received rose from nothing to more than 80 percent of the amount budgeted (World Bank 2004b).

Poverty was caught in a pincer between highly effective private giving and job-creating, growth-producing businesses. All these improvements spilled over into the burgeoning unofficial aid industry, which some term the “undergrowth.” It gradually became clear that unofficial aid projects were delivering far higher returns than official ones. By 2020 that was provable beyond reasonable doubt. Internet platforms made it effortless for private donors to find worthy projects that were well governed, professionally managed, and fully certified. Independent monitoring and certification became a large and competitive business: charities and aid agencies were expected to demonstrate results, just as companies were expected to generate profits and produce audited accounts. Transparency and accountability became commonplace. In 2020 citizens of rich countries could order a new well or power generator for delivery in Sudan as easily and with the same assurance as they could order flowers for delivery to their grandmother in 2005.

The end of official aid?

Events of 2020–30 have left many commentators concluding that we have seen the end of the official aid industry. The few big infrastructure projects that cannot be handled by the private sector—such as in pariah closed economies—have been picked up by the Chinese and Indian
development banks. Health, social, and environmental aid is now provided by such a vibrant, efficient, and well-funded combination of charity and private business that it is hard to see where the dinosaurs of official aid fit in. The only function left for them is knowledge management—consulting, research, and spreading best practices. Even this work is funded largely by universities, foundations, and user fees. Looking back, we can see that official aid once had an important role to play in development, but those times are long gone.

What does the “undergrowth” of the aid industry look like today? It defies description. We see a huge range of approaches, some experimental and some well established.

Consider a typical output-based aid project in Cameroon. It is designed by a small but expert Cameroonian service company, delivered by a huge Chinese multinational contractor, financed by a New York–based investment bank, and ultimately funded by donations gathered from all over Europe with the help of favorable tax treatment and an “aid matching” Web site. It seems quaint to suggest that government-to-government aid, long discredited in the eyes of rich and poor people alike, would have anything to do with such a project.

Economist Paul Seabright (2004, p. 15) reports that after the collapse of communism a senior Soviet official seeking advice on the workings of capitalism asked, “Who is in charge of the supply of bread to London?” An aid agency official transported in time from 1990 to 2030 might ask a similarly naive question about today’s aid system. Nobody—not even a small group of institutions—is in charge of the aid industry of 2030.

References


Notes

1. Data are from the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD).

2. Data are from the World Bank’s World Development Indicators database.