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The influence of China and emerging donors aid allocation: A recipient perspective

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ABSTRACT

From the perspective of recipients, the increasing influence of China and emerging donors in the aid landscape represents an opportunity to attract additional resources to finance development and improve their control over their development agenda. This paper investigates how African countries and other LMICs deal with this complex and changing aid landscape and explores how government fiscal behaviors and private agent anticipations regarding aid flows are affected.

We used several measures of fiscal behaviors and we were not able to confirm empirically the fear of traditional donors about a macroeconomic disaster that would follow emerging donors aid allocation. Moreover, the results indicate that economies receiving additional aid flows from China enhance their fiscal response to aid through an increased domestic economy aid absorption rate.

1. Introduction

The growing influence of emerging economies is leading to more choices and more finances, and developing country governments' welcome this situation. Woods (2008) argued that competitive pressures between donors give governments a certain amount of leverage. Analyzing the aid landscape in Nicaragua, Roussel (2013) reported the following citation from an interview with a representative from the German Embassy, illustrating the empowerment of recipient government:

> '*we were basically told* "*this is your money…we can talk about it and if we agree, then let's do it, and if not, just take your money home*". (…)*This is a new attitude or a new strength that the government didn't show before.*'

The same empowerment is also observed in Ethiopia, Cambodia, Fiji or Zambia by Sato, Shiga, Kobayashi, and Kondoh (2011), Greenhill, Prizzon, and Rogerson (2013) and Schmaljohann and Prizzon (2014). These recent country case studies describe the changing aid landscape and show that emerging donors provide a policy comfort to the recipient governments and diminish

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the leverage of traditional donors, who are disinclined to impose policy terms.[1] Thus, donor diversity would enhance recipient ownership of the development agenda.

According to Paulo and Reisen (2010), more than 30 donor countries operate outside the Development Assistance Committee (DAC). We choose the term "non-DAC donors" to describe these actors, even if it defines the group by what they are not, rather than by what they are. The most important non-DAC donors included China, India, Brazil, Venezuela, Mexico, Russia, United Arab Emirates, Saudi Arabia, South Africa, Kuwait and Thailand. The category of non-DAC donors represents a broad spectrum of actors with diversity in various aspects of development cooperation, from strategic priorities to regional and sectorial focus to institutional arrangements.[2] However, they have in common an at least partial rejection of DAC-related principles and practices and a rhetoric promoting a different kind of engagement with the countries to which they provide assistance. The 2005 Paris Declaration on Aid Effectiveness emphasized that aid should support ownership, harmonization, alignment, results and mutual accountability. Non-DAC donors like China have set similar principles to govern their aid, but a key difference is in the application of conditionality. The members of the DAC are practiced in banding together to impose economic and political conditions (policy reforms, structural economic changes or good governance) to aid allocations (Bräutigam, 2011). Moreover, as South–South Cooperation is based on mutual interest and local ownership, another difference is the practice among the DAC donors to develop country assistance strategies which sometimes reflect the donors' goals more than those of the country they are assisting.

If concerns about aid fragmentation, increasing transactions costs, or debt sustainability are preoccupying issues for DAC donors, recent country case studies (Greenhill et al., 2013; Roussel, 2013; Sato et al., 2011) about recipients of non-DAC aid showed that these concerns did not appear as priorities for recipient governments. The overwhelming priority is to raise additional resources to finance development despite the associated transaction costs. Some recipient countries are taking a strategic approach to manage funds from traditional and emerging donors. They intend to use the presence of new donors to increase their negotiating capital in relation to traditional donors, and secure better outcomes in relation to their priorities (Greenhill et al., 2013).

The purpose of this analysis is to better understand the implications of the changing aid landscape for developing countries. Our analysis will explore both recipient governments and private agent perspectives regarding the "welcoming emerging donors" strategy.

First, we would observe what happened to fiscal variables during the last decades in countries that have received significant amount of aid flows from China and other non-DAC donors. Our paper investigates the behavior of a comprehensive set of fiscal variables (government spending, the level of tax revenues, borrowing behavior) during the period 1980–2010 on a sample of LICs and other developing countries receiving aid flows from DAC donors and emerging donors. The objective is to find if the presence of non-DAC donors in the aid landscape as new development finance providers is leading to specific fiscal behaviors from recipients or similar to those demonstrated by Ouattara (2006) about DAC aid flows.

Evaluating the absorption of aid flows, Berg et al. (2007) and Foster and Killick (2006) found that most aid appears to finance capital flight, rather than an increase in net imports. In countries where political institutions are weak or corrupt, aid transfers may lead to capital flight and undermine growth. Unlike the western donors providing budget support which often finances capital flight from developing countries to high income countries, emerging donors like China primarily deliver aid through discrete projects. This could have positive implication for the effective absorption of aid. Furthermore as the debate about emerging donors is analyzed by the literature of aid effectiveness largely focused on traditional donor behaviors, the value and the implication of the contribution of the new southern donors to development cooperation seem to be under-appreciated by economists. To fill this theoretical gap, Lin and Wang (2015) propose to look the contribution of China and other emerging donors to development cooperation through the New Structural Economics theory. In fact, China, Brazil or India like other rising donors are utilizing their own tacit knowledge and intimate experiences of structural transformation in the past 40 years in their approach of development cooperation. The originality precisely lies in the close linkage of development assistance to the provision of resources, foreign direct investment, trade flows and technical knowledge transfer.

They finance infrastructure projects targeting and addressing African countries and other LICs bottlenecks to growth (water; electricity; road and rail; air transport; and telecom). Overall, infrastructure resources committed to Africa by these countries jumped from US$1 billion per year in the early 2000s to over US$10 billion in 2010. Chen (2013) found that China alone accounts for 34% of all aid to infrastructure in SSA, higher than other multilateral and bilateral donors. However, even if South–South development cooperation is rather perceived as an opportunity for doing business, trade and investments for new donors, developing countries believe that working together with emerging donors could enhance their capacity in self-development.

The second part of our analysis in this paper seeks to find out how the private sector behavior regarding aid flows is also influenced by the specific characteristics of non-DAC donor activities.

[1] Due to limited capacity in line ministries, the governments of Fiji and Vanuatu expressed a stronger preference for projects that target Technical assistance and capacity-building activities. The Ethiopian government clearly prioritizes projects that fit with national strategy with higher concessionality in financing, lower conditionality and maximum commitment.

[2] For example, much of Brazil's development cooperation initiatives revolve around its flag-ship program, termed 'technical cooperation', which emerged in the late 1960s and eventually became a core theme of the country's overseas aid activities. The primary goal of its technical cooperation initiative is to contribute to the development of the partner countries.

Following another policy, India through ITEC (Indian Technical and Economic Cooperation Program) offers training facilities to both civilians and military officials, supports project management activities, provides disaster relief and supports other development initiatives. The country offers lines of credit (LOCS) via the Exim Bank of India to foreign governments, regional multilateral banks and other financial institutions (Quadir, 2013).