

AN OVERVIEW OF DEVELOPMENT AID IN 2040

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The paper presents a possible scenario of development aid in 2040 and in no way attempts to predict the future. It attempts to review the development aid architecture in present global financial crisis which is acting as a 'game changer' in global development process. Issues of aid effectiveness, off track MDGs and flawed and poor targeting adversely impacting poverty reduction efforts would be acting as another important facet in this global process. Supply side failures like aid targets slipping out of reach together with the above said dimensions would bring development aid at cross roads in 2016. The paper shall attempt to provide alternative development architecture as a way forward to overcome this gloomy situation. The paper is set in the period after 2040 and the overview is based on presently available evidence of long term changes, logic and imagination. The paper encourages present aid scholars and policy makers to think about possible response for the future.

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In an annual general body meeting of International Aid Organization (IAO) held in Beijing yesterday, the donor and recipient countries have jointly reviewed the performance of Official Development Assistance (ODA) disbursed in 2039. After considering the ODA required by qualifying poor recipient countries, they also approved the next financial year's budget for International Development Aid Fund (IDAF). USA and BRICs (Brazil, Russia India and China) were the top contributors in volume terms to IDAF in 2039, whereas DAC donors still play a very important role in contributing ODA to IDAF. BRICs contributions have been significantly on the rise to IDAF for the last 5 years, mainly due to continuous high growth rate evidenced during the last three decades. Major recipient countries are still among the bottom billion countries. Multilateral banks like World Bank, Asian Development Bank and African Development Bank are the main conduit of aid delivery under the overall aegis of IOA and most of development aid is channelled through these sources in the poor developing countries.

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Introduction

Development aid architecture has evidenced a lot of changes from its colonial era, when the aid was delivered from ruling government to their colonies, to partnership based approaches between rich developed countries and poor developing countries over a period of time (Riddell, 2007, p.25). Before looking into the present aid architecture in 2040, it is proposed to reflect on major aid events occurred in 2015, which brought the paradigm shift in development aid for the last two decades. The failure of the Millennium Development Goals (MDGs), weak aid reforms and the failure of achieving aid targets is dealt first along with a brief overview on the impact of financial crisis on development aid in 2008. After that, an overview is presented on how IAO and IDAF got structured and started functioning and what roles they play in the present time. The paper will also explore the role of multilateral and bilateral agencies and the dynamics of conditionality and ODA allocation in the poor recipient countries. Different funding instruments like loans or grants, role of Non-Government Organizations (NGOs) and an account of south-south cooperation with traditional DAC donors will also be presented.

Development Finance Architecture and Global Financial Crisis

Looking back into the history, the global financial crisis in 2008 posed a serious challenge to maintain the aid inflows from the rich nations to the poor countries. The projected decrease in aid was similar to the Nordic crisis of 1991, when Norway's aid fell by 10%, Sweden's 17%, and Finland's 62% during the period from 1991 to 2000 (Roodman, 2008). Similar experiences were observed during the Japan's banking crisis, 'when Japan's aid fell by 44% between 1990 and 1996, and never returned to its pre-crisis level' until 2000 (ibid). OECD call for aid pledge from donor countries in 2008 and warning coming from its Secretary-General and the chair of Development Assistance Committee (DAC) to prevent the financial crisis from generating an aid crisis, proved instrumental and rescued aid from falling into the trap of the development crisis (OECD, 2008).

In the OECD countries, where the economy was facing a acute recession in 2009, governments with large deficits were considering to cut aid budgets to maintain the fiscal balance. Governments were making massive intervention and huge financial commitments (Mold, et al., 2008, p1). Many politicians were wondering if they could

afford to send taxpayers' money abroad when the financial crisis was starting to affect their economy (Zimmerman, 2008, p.1). At that time, governments had to take some tough fiscal choices. At the same time, perhaps surprisingly, polling data started showing that voters, initially from France and later from all OECD countries, continued to strongly support aid to developing countries, despite the financial crisis (ibid). This prevented donor countries an "easy" cut in their budgets and aid was restored to its 2007 level, even in the gloomy recession years (ibid).

The consequences for the development finance and the global financial architecture during financial crisis were very important (Reisun, 2008). Since 2000, development loans by the World Bank, the IMF, and the regional development banks had been crowded out by private-sector lending throughout the boom decade (ibid). But during the financial crisis, the supply of public development finance rose and regained some of the attractiveness to poor countries that it lost during the boom period (ibid). Emerging economies' high foreign exchange reserves like from China were leveraged through multilateral development banks to restore development finance.

Effective Aid by 2015: What & How much?

'When donors and partner countries endorsed the Paris Declaration on Aid Effectiveness in March 2005, they were united by a common objective to build a stronger and more effective partnerships that will enable partner countries to achieve their own development objectives. They pledged to achieve this objective by introducing far-reaching changes that imply not just a new way of thinking about their partnerships and the role of aid, but also new behaviours and practices' (OECD, 2008, p4.).

In the fifth high level forum on Aid Effectiveness in 2015², it was found that indicators on technical cooperation and untying aid had been easily achieved. The recipient countries did not have to accept resources any more, which were not linked to their priorities. The requirements by donors that aid be used solely for the purchase of goods and services, including technical assistance and consultancy services originating in the donors' countries (Riddell, 2007, p.358), were no longer seen afterwards. Indicators on parallel project implementing agencies, accurate recording of aid flows in countries budgets and predictability of aid made good progress but ran short of the targets. There was also very little progress made on the operationalisation of country strategies, donors' use of public financial management system, coordinated mechanism for aid delivery, missions and country studies and mutual accountability.³ The efforts on aid reform made a long progress but targets were not reached even 10 years after the Paris declaration.

Missed Millennium Development Goals and Poverty Level

Final evaluation of MDGs brought mixed pictures on various goals. In the case of first MDG which called for the reduction of extreme poverty and hunger by half, there were serious shortfalls in fighting hunger and malnutrition, although the poverty goal was met at the global level. The human development MDGs like reducing child and maternal mortality, primary school completion, empowerment of women, and sanitation were partially met.⁴ There was also a considerable variation

² Fourth High Level Forum on Aid Effectiveness will be organised in 2011.

³ Trends of 2008 survey on monitoring the Paris Declaration

⁴ Trends observed in World Bank Global Monitoring Report

across regions and countries. At the regional level, Sub-Saharan Africa was behind on all MDGs, including the goal for poverty reduction. South Asia lagged on most human development MDGs. At the country level, most countries were off track to meet most of the MDGs, with those in fragile situations falling behind most seriously. This posed specific challenges for the aid positivists across countries and international institutions.

The composition of world poverty had changed noticeably over time. Poverty had been declining at the rate of about one percentage point a year, from 52 percent of the developing world's population in 1981 to 15 percent in 2015. The number of the poor fell more than half a million during this period. China's success against absolute poverty had clearly played a major role in this overall progress but the developing world outside China was not on track to reaching the MDG for poverty reduction. The number of the poor had fallen sharply in East Asia, but risen elsewhere. The trend rate of global poverty reduction of 1% point per year turned out to be slightly higher mainly due to the higher weight on China's remarkable pace of poverty reduction. China attained the MDG early in the millennium, almost 15 years ahead of the target date. Over 1981-2015, the poverty rate⁵ in South Asia fell from almost 60% to 32.5%. One third of the world's poor were living in SSA in 2015(Chen and Ravallion, 2008).

Aid Targets Slipped out of Reach

Even after 45 years, when the UN General Assembly first pledged all economically advanced countries to increase their ODA to .7% of its GDP, it never reached the expected level. Despite continuous urge from the world leaders in financing for development conferences at Monterrey & Doha in 2002 and 2008 respectively, aid targets slipped out of reach. After Monterrey, there was a slow increase in the volume of aid from its 2002 level and it reached more than \$103 billion in 2007 (OECD, 2008). During the global financial crisis, donor countries started feeling pressure on their aid budgets. Other developed countries who did not formulate the time table to reach their ODA target were urged to make definite efforts (United Nations, 2008). Even after that it did not reach to its desired level of .7%. The United Nations MDGs, which was expecting at least .44 % of industrialised nations GNP in 2006 and .54 % by 2015 to achieve the goals missed to achieve most of the goals by 2015 (UN Millennium Project, 2002).

Development Aid at Cross Roads in 2016

So in 2016, the world was at the crossroads. First, the developed and developing world knew, that the poverty still existed which had the regional variation especially in the bottom billion countries and that the MDGs targets had not been met. It meant that the provided aid was not allocated in the most efficient way to tackle poverty for those who needed it most. The aid allocation decisions were not simply made on poverty reduction interest but 'also profoundly influenced by the political, strategic, commercial and historically rooted interest of most of the major donors' (Riddell, 2007, p.386). Second, the aid targets were slipping continuously from expected .7% of rich countries income and there was a continuous rise of non-traditional donors and innovative financial instruments to fund the development efforts in poor countries. The major cause of this problem was that official aid giving remained based on the voluntary decisions of each donor government, resulting in a gap in aid provided and aid needs of poor countries as a whole (Riddell, 2007, p.386).

⁵ At the \$1.25 poverty rate

Aid reforms through Paris Declaration mandate have succeeded in few of the key areas within alignment principle but reforms in ownership, harmonization and mutual accountability principles were partially achieved in 2015. The last and the most important one was that there were few countries that were not doing well in their economic growth and were continuously trapped in such a situation whereas few countries like emerging economies were continuously growing. Especially the private and foreign direct investment, export diversification and linkage to the world economy along with revenue generation were in very poor conditions in countries, which were termed as failed or fragile states.

International Aid Organization

International Aid Organization was established in 2016 on the wake of major failures on aid volume, MDGs and aid effectiveness efforts, further leading to the reform of international aid architecture (ibid, p394). IAO was established on the recommendations of the United Nations Economic & Social Council (UNECOSOC) and OECD. IAO's main function is to review the strengths and weaknesses of contemporary official and non-official aid relationship, and respond to the inadequacy of aid funding (ibid, p.400). It also has an oversight on the way the aid funds are raised, allocated and utilized for the poverty reduction efforts in the poor developing countries. IAO was to build upon the work done by all the multilaterals and bilateral development partners and serves as an 'aid ombudsman' to provide overall vision to the development aid in rich and poor countries (ibid, p.394).

International Development Aid Fund (IDAF)

IDAF is a facility established in 2016 within IAO. It is financed by compulsory contributions from the 'rich' club like the USA, Korea, the UK, Russia, Canada, France, Germany and Japan and other European Union countries as well as few upper and lower middle income group countries (ibid, p394). The main function of IDAF is to raise money from official and private sources to match the total ODA required by the qualifying poor countries (ibid, p.394). Generous donor countries from the EU maintained their previous level of aid as a % of GNI level but still few countries were contributing less than .5%. The criteria for raising the resources had been redesigned for the rich countries and a compulsory contribution of .5% of their GNI was agreed among as the minimum contribution to the IDAF. The major contributions coming to IDAF can be classified as official donors and non-official donors.

Looking back to the history of the last 25 years of IDAF, it is interesting to observe how the aid landscape has changed over a period of time in terms of donors. The aid from official sources which used to be only coming from OECD rich countries (DAC donors) and few non OECD donors started to change after 2015 onwards. In 2015 they were divided among four groups. First there was a group of OECD members who were not members of the DAC – countries like Turkey, Korea, Mexico and several other European countries like Czech Republic, Hungary, Poland and Slovakia (Manning, R., 2006, p3). The second group were the new EU member states but not members of the OECD, who made their best endeavours to reach 0.17% of GNI by 2010 and reached 0.33% by 2015 despite small absolute ODA amounts given the size of their economies (ibid). The third group was that of the Middle East and OPEC countries like Kuwait, Saudi Arabia and UAE (ibid). The fourth group

were non-OECD donors like Malaysia, Thailand, Venezuela, Chile, BRICS (Brazil, Russia, India, China, and South Africa), China Taipei and Israel (ibid).

2040: An Era of Bilateral & Multilateral Synergy

During the last three decades, the proliferation of donors has not been reduced. However, for the first time in the history of aid, small bilaterals who became dependent on multilaterals have closed down their government to government operations. Though the bilateral interests continue to define the development aid world, it is the highly competitive environment dominated by multilateral agencies under the aegis of IAO, which enjoys the government to government operation nowadays. The donor groups, who are interested in providing significant sum of ODA to developing countries directly, have to get terms and conditions approved by International Commission on Aid and Development. It must be as per the ODA guidelines through which donors can channel their ODA flow directly through non government organizations. Nowadays multilateral aid dominates in aggregate (90% of the total ODA) and it has replaced the dominance of bilateral aid, which amounted to 70% in 2006 (Burall et al., 2006).

This paradigm shift has happened mainly due to concerted efforts to reform the multilateral system and improve multilateral performance over the past two decades (Danida's Evaluation Department, 2008, p.10). In doing so, commitments to poverty reduction, aid effectiveness principles, and considerations of the ideal 'international aid architecture', all played an important part (ibid, p.10). Different considerations of foreign policy goals, domestic constituency concerns and structural considerations led the bilateral donors to compete in different directions with each other (ibid, p.10). Poverty reduction and poor countries were often not at the forefront of donor considerations in making resource allocations decisions.

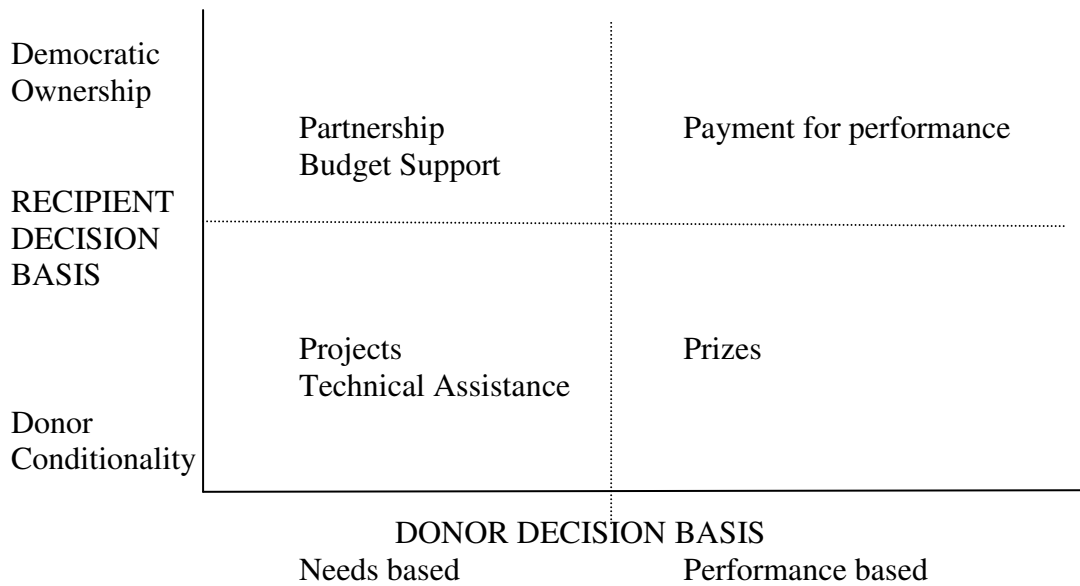
Conditionality & Resource Allocation

For the last five years, the resource allocation trend suggests that there has been a continuous shift from needs based approach to performance based approach, while IAO is making decisions to allocate the resources to recipient countries. Donor conditionality is also shifting towards more democratic ownership as demonstrated by the funding instruments used for the resource allocation of IAO. The interaction between donors and recipients is reflected by the decision making criteria on two different axes. On one axis, the donor decision making to give aid is reflected from the needs based approach to performance based approach. Whereas on the second axis, the recipient decision making to receive aid is based on the donor conditionality towards a shift to the country ownership.

On the basis of the above, funding instruments can be classified into the following four categories

1. Project Technical Assistance – Needs based and conditional to donor conditionality
2. Prizes – Performance based but still conditional to donor conditionality
3. Partnership Budget Support – Needs based but democratically owned by the recipient country
4. Payment for Performance - Performance based and democratically owned by the recipient country

Figure 1 - Ellie's Diagram on Conditionality



Source: Discussions during aid management lecture 30 Oct 2008

Table -1 Funding Instrument & Resource Allocation

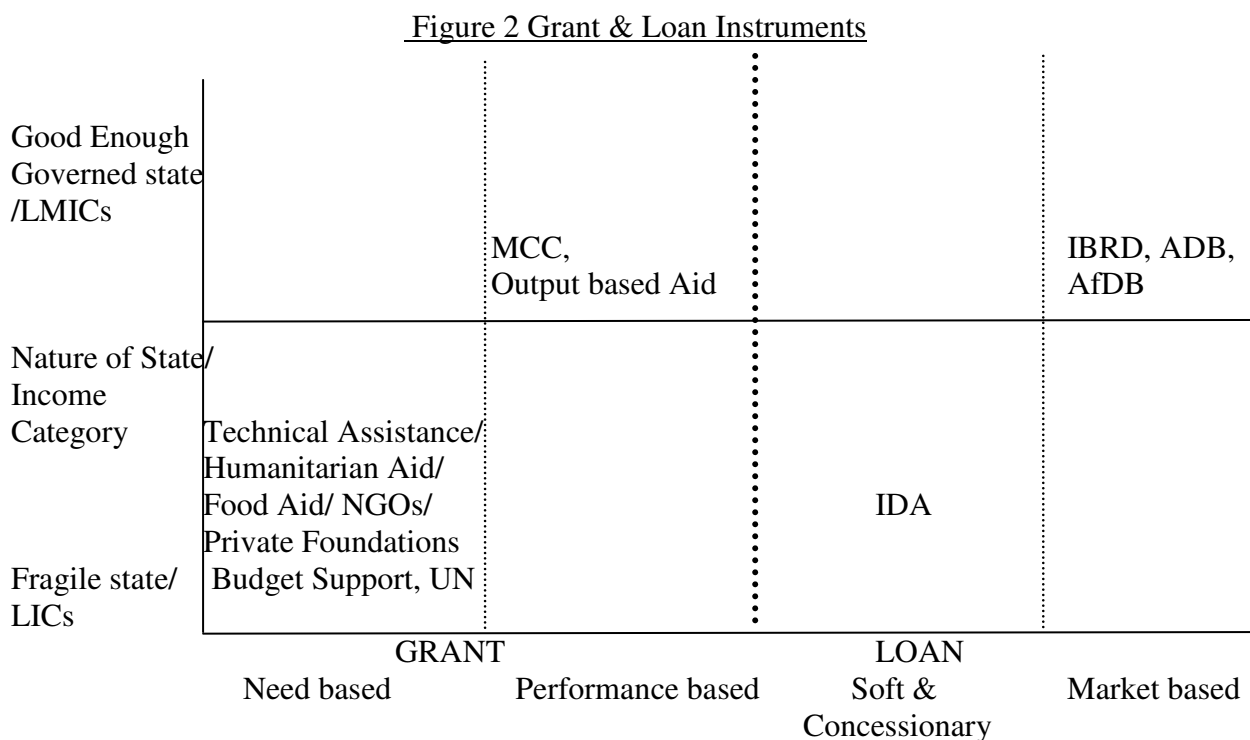
Funding Instrument	% of resources allocated by IAO				
	2035	2036	2037	2038	2039
Payment for Performance	11	13	14	15	16
Partnership Budget Support	30	31	32	33	34
Prizes	36	37	38	39	40
Project Technical Assistance	23	19	16	13	10
Total	100	100	100	100	100

Source Author's calculation 2040

The above figures suggests that project technical assistance is decreasing rapidly i.e. from 23% in 2035 to 10% in 2039, which indicates that most countries are no longer accepting needs based and funding instruments conditional to donor conditionality. There has been a continuous rise of recipients accessing prizes, partnership budget support and performance payment. This trend indicates less dependence on needs based and conditional aid and improved country ownership and performance in the overall development aid.

The donor – recipient relationship is not as controversial as it was 25 -30 years back, when the recipients pursued a given set of policies, advocated by donors, which served as a precondition for providing aid. When a debate conducted back to assess the impact of policy conditions and advice, it focussed on two broad questions (Riddell, 2007, p.235). The first was to understand to what extent the recipients had complied with and implemented the policies that the donors had placed on the table with the aid they had given (ibid, p235). Secondly, had the conditions that the donors had sought to apply been the right ones (ibid, p235). The aim of the debate about the policy conditionality, ownership and reform was to make the gradual shift from needs based aid to performance based aid and less policy conditionality to country owned and negotiated aid. 2040 is gradually moving towards the same direction.

Grants or Loans: Development Finance Today



Nowadays, the debate on grants vs. loans seems to be fading away in the new aid architecture. Despite efforts of banning loan in the past, both grants and loans still are widely used as an aid instruments. Even for fragile states and low income countries (LICs), soft and concessionary loans from IDA are the major source of development aid financing. IDA soft window operates with the principle of ‘ongoing forgiveness’, where loans are made available with predetermined conditions and are independently audited by the representatives of IAO (Klein and Harford, 2005, p 4). Performance incentives are introduced in the IDA operations; every year, when the conditions are met, that year’s loan payment is converted into grant. The proportion of loan which adheres to the performance conditions is thus converted into a grant gradually and the rest is treated as a loan. To prevent the debt trap for these fragile nations, which was evident before 2015, IAO has taken a very important measure. Repayments from these debtors are deferred until they reach 5% of GDP growth rate for three consecutive years (ibid, p4). Another proposal is on table with IAO when these countries can start paying back to IDA once they have reached high prices to predetermined commodity (other than oil and minerals). The proposal is expected to be discussed and decided by the next annual body meeting, scheduled to be organised in New York next year (ibid, p4).

All the NGOs, UN organizations and private foundations are focussing on fragile states and low income countries on the recommendation of IAO. Technical assistance in terms of human resource, humanitarian aid and food aid are predominantly channelled towards these countries which are still considered as a bottom billion countries. LMICs, who are termed as ‘good enough governed states’ are predominantly recipients of performance based grant instruments like MCC, GPOBA (an output based aid programme) and climate challenge fund (Grindle 2002). They are also the biggest recipients of market based lending programme of the World

Bank and regional multilateral banks. Most of these market based loans are meeting their infrastructure financing needs to complement their steady economic growth.

Role of Non-Government Organizations in Development Aid

On the wake of long term changes evidenced in the ODA trend in last two decades, NGOs have become an important conduit of delivery for all the bilateral programmes in the LIC and LMIC. As the new guidelines of IAO prevent small bilaterals to channel resources directly to government, NGOs have become the darlings of such agencies. Besides their graduating role as implementers, they are also acting as watch dogs for the huge amount of development aid flowing into their respective constituencies. Last year, the total value of NGO aid funded activities was almost equivalent to 25% of the total ODA. NGOs' priorities in advocacy, lobbying, awareness raising and campaigning related to increased aid and debt relief has shifted towards accountability and transparency of multilateral organizations. NGO's role is also increasing during the emergencies and the humanitarian response.

Relationship between North and South NGOs are highly debated and coordination issues among them appear to be surfacing from the last year's International NGO Network board meeting. In the recent past, there have been evidences that the international NGOs pay greater respect to their official donors than to the priorities of their local counterparts (Koch, 2008). There is also a huge disparity in the representation of NGOs from developing countries and NGOs from developed countries in board membership of the world's largest development NGOs (ibid). Last year's report indicates that less than 20% board members are from developing countries. International civil society reforms committee are meeting later this year to decide on the fate of the Paris Declaration for International NGOs, similar to the aid effectiveness declarations endorsed by donor and recipient governments long back in 2005 (ibid).

South-South Cooperation vs. Traditional DAC Donors

South-South cooperation has been recognised not as an option in 2040 but to effectively complement North-South cooperation. This is an era of multi polar world where south-south cooperation has emerged very effectively since its importance was first recognised by OECD donor countries in Accra in 2008. Southern countries policies on solidarity, cooperation and partnership (G77, 2003) are reflected in the incentive (conversion from loan to a grant upon successful achievement of the conditionalities), which is provided to the recipient countries. This condition has been introduced in 2030 after a shared understanding between the traditional DAC donors and southern donors to encourage the implementation of the poverty reduction programmes and ensure the debt sustainability of the recipient countries.

The policy of major southern countries like China, India, Brazil and South Africa is very clear to the world community. Trade with Africa and other lower income countries, and not aid, is still their first priority and they treat southern countries as an equal partner in development. For the last three decades, the effect of the two giants' demand for commodities and their ability to export cheap labour-intensive manufactures has had major implications for the whole development paradigm in Africa (Manning, R. 2006). Before establishment of IAO, DAC donors were concerned when southern countries were increasing their ODA to low income countries (LICs). The perceived risks were LICs might have prejudiced their debt situation by borrowing on inappropriate terms from southern donors, who were not

following any OECD DAC standards (ibid). LICs were also at risk to use low-conditionality aid to postpone necessary adjustment and they might waste resources on unproductive investments (ibid).

For a period of time now, the DAC members have no longer been the major providers of aid finance. USA and the BRICs were the top contributors last year and continue to enjoy larger say in IAO. DAC donors who were expecting to standardize the definition of ODA with the emerging donors including south-south cooperation countries have learnt from the experience of southern countries and now encourage further development of triangular cooperation (ibid). OECD's encouragement to non DAC donors to use the Paris declaration principles as a point of reference in providing development cooperation never kicked off. The principle of conditionality followed by OECD donors and partnership principle of southern countries were the main point of divergence, which created the divide between them. Few of the southern countries like Vietnam and Indonesia joined the OECD DAC, where as giants like China, India, South Africa and Brazil are still at the arms length with OECD principles of conditionality.

Private Aid Flows

Private financial flows like foreign direct investments, remittances from migrant workers, equity flow, loans without a sovereign guarantee, have increased manifold for the last two decades (Harford et al., 2005). These private financial flows have been growing for a long time and there had been efforts to consider them as an alternative to ODA (ibid). Last year, these private aid flows were five times higher than official flows – loans, grants, export credits and sovereign debt. In 2002, private aid flows were twice as much as ODA. Initially there was confusion among the donor countries that the increased private flows could be considered as their shared commitment towards increased contribution towards poverty reduction in developing countries, specially, when their share of ODA to GNI was reducing during financial crisis. The WTO and IAO, on the recommendation of OECD, considered both to be calculated separately as is now the practice.

It is important to mention the name of few non-official donors which have flourished in recent past. These are a new global partnership for climate change administered by global fund on climate change (same in the line of GFATM), Debt 2 Climate initiative and solidarity tax on global corporate transactions. Besides these Bill & Melinda Gates foundation, product RED, and solidarity tax on aircraft tickets remains the biggest contributors to the private official flows. Aid flows from solidarity tax on global corporate transactions are jointly administered by World Bank and regional multilateral banks under the aegis of IAO. Whereas others are either delivered by the special purpose vehicles created for the same or in partnership with existing initiatives.

Global Climate Change Finance Architecture

Climate change and global warming is the major concern nowadays and IAO has been entrusted the responsibility to ensure financing for the recommendations given by UN Framework Convention on Climate Change (UNFCCC). IAO with the support of private sector established the Global Fund on Climate Change (GFCC) in 2030. GFCC is a specialized vertical fund which provides oversight and ensure climate change finance requirement in the poor developing countries. The financial instruments under this lending window are both concessional as well as market based.

For the last ten years, majority of the grants has been allocated for the resettlement of the displaced community in the low-lying areas, and to some small island states. Extreme weather events like floods, droughts and storms are also being immediately responded through this funding window. Most of this immediate recovery plans qualify under the humanitarian aid. IAO has asked the World Bank to continuously innovate and pilot new approaches of financing under the global regulatory framework established by UNFCCC.

Way Forward

Development aid has survived for more than 100 years and it is still an important tool for international development diplomacy. Bilaterals and multilaterals-both have created their own niche from where they are furthering their poverty reduction goals. Neither the needs based funding nor is the conditionality done away with. Simultaneously, recipient ownership and performance based funding is on the rise. The incentive component to convert loan into grant, on the basis of performance of recipients to effectively implement the policy conditions, is working well. The role of new donor countries and their contribution to ODA has been established, given the money they are bringing to the development aid table. Due to the huge aid inflows through NGOs, the issue of coordination among the northern and southern agencies is on the rise. The future will see some reforms in which they operate.

Changes are constantly taking place and it is difficult to predict who the major players will be in 30 years from now, in 2070. What can be said with certainty is that they will be facing the problems that have started to appear in the present time already. Despite this convincing improvement in aid architecture, the development aid is facing two problems. One is the problem of addressing the issue of global warming and the second one is how to deal with the failed states. Neither the limitations on aid fund nor the technical solution is creating hurdles but the failure of delivering promises on the climate change in the past, has brought the world to a situation, where frequent natural disasters are posing major threats. The problem of failed or fragile states seems to be challenging international community once again to formulate effective responses in the days ahead to come. They have failed to keep pace with other progressing countries that have made best use of aid and are now reducing their aid dependency through their increased participation in global trade. The next few decades will represent a great challenge in terms of responding to both problems – failed states and global warming.

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