Sectoral Allocation of Aid: What Has Changed?

Official development assistance consists of grants and concessional loans, which are used for socio-economic development in developing countries. Official development assistance (ODA) can be direct transactions between donor and recipient country (bilateral aid) or it can be distributed via multilateral development organisations (OECD 2009). This report gives an overview of different aid sectors and provides information on how the allocation of ODA has changed over time. The dataset referred to in this report shows the allocation of bilateral ODA for different sectors by individual Development Assistant Committee (DAC)[1] donors and covers the sectoral allocation of aid from the year 1987 to 2012 (the dataset is available in the DICE Database: www.ifo.de/w/7dkQfcWa). Numbers are percentage shares of all bilateral commitments.

One of the most interesting changes in aid allocation during the time period presented (1987–2012) is the trend in aid allocation from other sectors to the social and administrative sector (Figure 1). An important reason for this trend is Millennium Development Goals (MDGs). The MDGs set the targets for development cooperation and they have a strong focus on poverty, health and educational development. Compared to the other aid sectors, the social sector has a clearer direct impact on those issues (OECD 2008). The humanitarian aid and the "other" sector have also gained importance over the time period presented, which can be seen in Figure 1. However, the share of the allocation to the other sectors has decreased. Commodity aid and programme assistance in particular have lost their share of the total bilateral commitments. There has also been a shift of aid from the agricultural sector to the social sector due to relatively lower transaction costs.

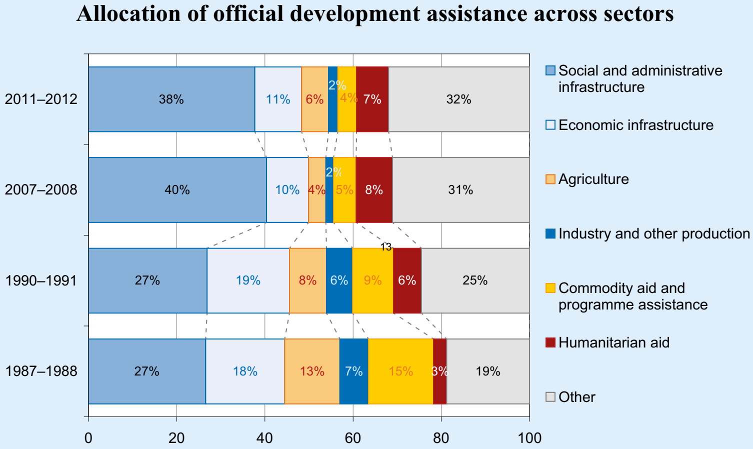
The **industrial sector** includes trade-related issues, construction, mining and other industry-related operations. The importance of funding infrastructural projects and industrial development with foreign aid has decreased over time, which is reflected in the overall aid allocation (Figure 1): The total share of the industrial sector dropped from seven percent to around two percent during the time period 1987–2012. For example, the share of Germany's aid to the industrial sector dropped from 10.8 percent to 1.8 percent during the time period of 1987–2012; and similar shifts can also be seen in other countries' aid allocation. In the 1960s in particular, it was thought necessary to fund big investment projects (highways, power stations, etc.) in developing countries in order to support development. This way of thinking was mainly due to the two-gap model, which was the widely used growth theory for many decades before the neoclassical growth theory became popular in the 1990s. The so-called savings-investment-gap meant that economic growth cannot be generated in developing countries because the level of national savings was not high enough. Spending huge amounts of foreign aid on expensive investments (which would not have been possible without external funding) was seen as the most effective way of boosting economic growth levels in developing countries (Easterly 1999). Due to the obvious failure of such policies and following new findings in academic literature on the topic, big investment projects went out of fashion, and nowadays funding the industrial sector is seen as relatively unimportant (Frot and Santiso 2010).

The **agricultural sector** has also lost significance as a target sector of foreign aid. This has provoked some criticism recently in developing countries, where the agricultural sector is often closely connected with the lives of the majority of people. A lesson can be learned from China's economic development: the fact that

[1] DAC = OECD's Development Assistance Committee.

Figure 1

Allocation of official development assistance across sectors



Source: Figure based on DICE Database (2014).

the state strongly promoted growth in the agricultural sector and improvements in its productivity was one of the reasons behind declining poverty in China (OECD 2013). However, only a few DAC-countries support their agricultural sector with a higher share than ten percent of their bilateral commitments. Finland and Norway are examples of countries with a relatively high share of spending on this sector in 2011–2012 (around 13 and around 14 percent respectively). Bucking the common downwards trend, Finland's commitments to the agricultural sector also experienced a slight increase over the time period of 1987–2012. The overall aid allocation of DAC donors to the agricultural sector dropped from around 13 percent to six percent during the time period in question (Figure 1).

Commodity aid and programme assistance usually consists of general budget support, food aid or other distribution of commodities into developing countries. Commodity aid is now widely seen as an ineffective way to support development. Commodities produced by donor countries are usually more expensive than the same commodities in the respective developing country, so the aid money would be better spent on supporting local production, instead of importing expensive commodities from donor countries. Similarly, technical assistance is often tied to hiring consultants from a donor country, although it would actually be more effective to use experts from the recipient country with the same knowledge, but a better understanding and greater experience of the local situation (Easterly 2007). The importance of commodity aid and programme assistance as a target sector has decreased significantly over the last few decades, falling from a total share of 15 percent to four percent of all official development assistance. For most DAC donors, the allocation of aid to this sector was between one and two percent in 2011–2012. Portugal's commitments to the sector (59.3 percent of all its bilateral aid) constitute an exception to this rule.

The sector of **economic infrastructure** includes, for example, transportation, communication services, energy generation and supply, as well as banking and financial services. Aid for this sector is supposed to promote the development of networks, utilities and services that facilitate economic activity. Its share of the total allocation of aid has remained largely stable in recent decades, but some changes in allocations can be seen at a country level. One interesting example is Austria: the country allocated a remarkable share of 53.4 percent of all its bilateral commitments to economic infrastructure in 1987–1988, but only 8.3 percent in 2011–2012. This was due to a stronger focus on gender equality and environmental issues in Austria's development cooperation policy; nowadays Austria identifies those as its key cross cutting themes (OECD 2013).

The aid distributed as **humanitarian aid** can be an emergency response, as well as reconstruction relief and disaster prevention funding. By its official definition, humanitarian aid is: "assistance designed to save lives, alleviate suffering and maintain and protect human dignity during and in the aftermath of emergencies. To be classified as humanitarian, aid should be consistent with the humanitarian principles of humanity, impartiality, neutrality and independence." (OECD 2013b). Humanitarian aid has experienced a slight increase in last decades, rising from a total share of three percent of all bilateral ODA in 1987–1988 to seven percent in 2011–2012. However, there is a high degree of variation between countries in their shares of humanitarian aid: from almost zero (Portugal, 2011–2012) to 17.7 percent (Luxembourg, 2011–2012).

The "other" sector includes general environmental protection, debt forgiveness and other actions related to debt. The total share of ODA allocated to this sector has increased in the last few decades from 19 percent (1987–1988) to 32 percent (2011–2012). One major reason for the size of the sector is the amount of debt relief grants issued in recent years. For example, Iraq and Nigeria received a combined total of USD 104.4 billion in grants for debt relief in 2006 (OECD 2009).

Nowadays the **social and administrative sector** receives the largest share of foreign aid (total 38 percent, 2011–2012). The sector covers efforts to develop the human resource potential of developing countries and includes education and health services supported by aid, as well as population policies, water and sanitation, and actions related to government and civil society. In recent decades the sector has gained more importance at the expense of other sectors, which can be seen in Figure 1. However, for most of the DAC donors, the social sector has always been a relatively important target sector: as early as 1987–1988, 14 out of those 23 countries allocated more than 20 percent of their bilateral aid to the social sector. In 2011-2012 Italy was the only country whose allocation did not exceed 20 percent, but many of the DAC donors allocated around 50 percent of their bilateral commitments to the social sector during this period.

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