



# AID, INFRASTRUCTURE, AND DIPLOMACY

A PRIMER



中国-尼泊尔世代友好 चीन-नेपाल

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# AID, INFRASTRUCTURE, AND DIPLOMACY

A PRIMER

NIRJAN RAI



Society of Economic Journalists - Nepal

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# FROM THE EXECUTIVE DIRECTOR'S DESK

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Policy Entrepreneurs Inc. is delighted to share its publication *Aid, Infrastructure, and Diplomacy - A Primer*. This work is a result of PEI's longstanding interest in infrastructure, foreign aid, and economic diplomacy in South Asia. It focuses on Nepal's five major bilateral development partners, namely, the United States, the United Kingdom, Japan, China, and India, and attempts to analyze the drivers, motivations, and characteristics of aid flow from these countries.

Historically, foreign aid has been a highly contested subject. Some argue that it enables low-income countries to build their economies and thus promotes global stability. Others maintain that it inhibits a nation's quest for self-determination. Recent years have witnessed significant geopolitical changes, including a heightened competition between the two major powers, namely the United States and China, and an erosion of multilateral norms. As a result, debates on foreign aid have intensified in countries that have long relied on foreign aid for their investment requirements. This *Primer* has been specifically designed as a tool for promoting informed public discourse on aid, infrastructure, and diplomacy at a time when the geopolitical context is shifting, the sources of foreign aid have diversified, and recipient countries face increasingly complex questions over the types of aid they should solicit or reject.

The *Primer* has been developed in collaboration with the Society of Economic Journalists-Nepal (SEJON), a non-profit organization of economics journalists working in print, electronic and online media. This work was supported by The Asia Foundation, Nepal.

We are confident that this *Primer* will be useful for everyone interested in Nepal's infrastructure and diplomacy discourse within Nepal and beyond. PEI welcomes suggestions and queries from readers and practitioners who are keen to further engage in this topic.



**Saumitra Neupane**

Executive Director

# FOREWORD

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It gives me immense pleasure to pen a foreword for this report titled “*Aid, Infrastructure, and Diplomacy – A Primer*” The publication is part of the series of publications by the Society of Economic Journalists, Nepal and the Policy Entrepreneurs Inc. aiming to promote an informed discourse around infrastructure and diplomacy in Nepal.

This primer comes at a moment when Nepal is adjusting its foreign policy to reflect China’s rise to superpower status and its impact on South Asian geopolitics. One area where this is particularly relevant is in China’s increasing use of infrastructure diplomacy to project influence. Historically, Nepal has relied on foreign aid, especially from western donors, to finance many of its large infrastructure projects. But as the motivations and the efficacy of western aid is questioned, and given Nepal’s large infrastructure gap, China’s aid, with its set of Chinese characteristics, is often projected as an attractive alternative for Nepal.

To shed light on this dynamic, this book delves into the details of foreign aid - from its origin to how it has evolved. It presents the aid practices of five of the most prominent bilateral donors of Nepal, namely the United States, the United Kingdom, Japan, China, and India, and examines the patterns, motivations, and institutions that drive their aid portfolio. It concludes with key observations with insightful observations on the overall trends of foreign aid and infrastructure diplomacy.

The document is a commendable attempt to provide factual information about foreign aid and diplomacy to the Nepali public. The observations detailed here can be of immense use not only to journalists who report on issues of foreign aid, diplomacy, and infrastructure, but also to other professionals, decision-makers, and academics interested and engaged in the topic.



**Janardan Baral**

President, Society of Economic Journalists - Nepal



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# 1. INTRODUCTION

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## 1.1 The Changing Context of Aid

Aid, in its modern form,<sup>1</sup> began in the immediate aftermath of the Second World War (WWII). It began with the United States (US) putting together the Marshall Plan to help rebuild post-war Europe while preventing the spread of communism into the region. Since then, the US and its allies have regarded aid as a key foreign policy tool for achieving both diplomacy and development.<sup>2</sup> In the process, these countries have created the framework, the institutions, and the agenda of the global aid apparatus.

China's rise as a global superpower, however, is beginning to impact aid. Sensing a new Great Power rivalry, other countries are developing strategies to adapt to this new global political reality. After decades of working and developing close economic ties with China, the US now confronts the question of how it might co-exist with another equal and contending superpower. China has indicated its interest and shown a willingness to chip away at the longstanding dominance of the US and its western allies, especially in areas where it feels the existing arrangement hinders its ability to pursue its interests.

One such area is foreign aid.<sup>3</sup> Much like its Western counterparts, China has long used aid as a foreign policy tool, but its approach has become more aggressive with its growing economic and political power. China seeks to lend a distinctly Chinese character to aid, veering away from established principles.

As Chinese aid increases in volume and significance, China's aid practices have drawn strong criticism from the west (and from parts of the global south). China is accused of using aid to secure natural resources and set debt traps, largely because China neither ascribes to the western conception of aid nor promotes transparency by making its data publicly available. This results in a lack of understanding of Chinese aid, leaving much room for speculation.<sup>4</sup> Despite China's attempts to portray its foreign aid initiative as a win-win situation for both the recipient country and itself, there are myriad narratives in circulation about its nefarious intent.

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1 Countries helping each other out is not a recent phenomenon. In the past, however, this was generally in the form of military assistance with strategic motivations. By modern aid, here we refer to aid that is given for non-military purpose such as development and humanitarian assistance. The intricacies of these motivations behind aid is discussed later in the report.

2 Bindra, Sukhwant S. "Foreign Aid And Foreign Policy." *World Affairs: The Journal of International Issues* 22, no. 3 (2018): 126-141.

3 OECD. 2022. "OECD Glossary Of Statistical Terms - Official Development Assistance (ODA) Definition". *Stats. OECD.Org*. Accessed January 22, 2022. <https://stats.oecd.org/glossary/detail.asp?ID=6043>.

4 Lynch, Leah, Sharon Andersen, and Tianyu Zhu. 2020. *China's Foreign Aid: A Primer for Recipient Countries, Donors, and Aid Providers*. Accessed January 22, 2022. <https://bit.ly/37eHihD>.

Many other countries such as Russia, India, and Turkey are increasing their foreign aid. These countries have significant political aspirations and seek to project their influence in what they perceive to be a new multipolar global order. They are often labeled as “emerging donors” despite having used aid as their policy tool for decades. The characteristics of their aid are different from those of their traditional western counterparts. Much like China, these countries prefer not to fully subscribe to the principles of aid established by the western countries.

All of these point to the fact that the role of aid in foreign policy is evolving to reflect the emergence of a new global political order. In this period of transition, donor countries – old, new, and those aspiring to be – are in pursuit of making sure that their aid maximizes their interest. However, this transition also has implications for the recipient countries as the competition between the donors presents new opportunities that they can exploit to their benefit. For Nepal, which considers its location between China and India as a strategic advantage, this is an unprecedented opportunity.

## 1.2 Aid, Infrastructure, and Nepal

Nepal’s history of large-scale infrastructure development is relatively short, going back only to the mid-twentieth century.<sup>5</sup> The Ranas, self-indulgent oligarchs who ruled Nepal from 1846 to 1951, had a very narrow rationale for investing in public infrastructure. For example, they invested in postal roads along the Terai belt to facilitate tax collections but did not invest in any major roads connecting Kathmandu to the rest of the country, as they believed that the surrounding hills served as a natural fortress, especially against British India.<sup>6</sup>

The succeeding political system of the *panchayat*,<sup>7</sup> in contrast, placed a strong emphasis on infrastructure and development. Politically, the government, led by an ambitious monarch, sought to accomplish two main objectives: to integrate the nation’s heterogeneous population under a single national identity and to minimize India’s political dominance over Nepal.<sup>8</sup> These intentions were reflected in the infrastructure built in those years. For example, the *Panchayat* government invested heavily, i.e., over a third of the national budget, in building roads across the country. The East-West highway, which ran parallel to the Nepal-India border, for the first time allowed Nepalis to travel the length of the country without having to enter India. It also invested in north-south roads such as the Arniko highway that linked Kathmandu to the China border, which sought to promote a vertical growth axis as well as to use China as a balance against India’s influence.

But with limited resources at hand, Nepal relied heavily on external donors to fund most of its large infrastructure projects. For example, India helped finance the construction of

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5 There are a number of projects, especially in the irrigation and water supply sectors that date back several centuries. In this document, however, we are focused on large-scale public infrastructure works.

6 Some moderate Ranas did eventually choose to invest in building a number of infrastructures such as health and education facilities.

7 Rankin, Katharine, Tulasi Sigdel, Lagan Rai, Shyam Kunwar, and Pushpa Hamal. “Political economies and political rationalities of road building in Nepal.” *Studies in Nepali History and Society* 22, no. 1 (2017): 43-84.

8 It should be noted that up until the 1960s, Nepali politics was heavily influenced by India. To the extent that Indian military check-posts were stationed along the Nepal-Tibet border and Indian Ambassadors were said to have full access and influence over Nepali cabinet decisions.

Nepal's first highway connecting Kathmandu to the Terai and half a dozen airports across the country. Similarly, China helped finance the highway connecting Kathmandu to its border with Tibet and a ring road around Kathmandu. Japan was a major contributor to projects in the energy and transportation sectors. Western donors such as the US, the United Kingdom (UK), Germany, and Norway, among others, also helped build infrastructure in Nepal. Apart from these bilateral donors, multilateral institutions began to finance Nepal's infrastructure projects in the 1970s.

Over half a century later, Nepal continues to rely on donors for infrastructure development. The country has a large infrastructure deficit and limited economic resources.<sup>9</sup> Multilateral institutions are now the major provider of funds, but bilateral donors remain significant. India is still among the largest providers of infrastructure aid, with two recent projects being the cross-border electricity transmission lines and petroleum pipeline. Japan has invested in prominent projects such as the Koteswor-Surya Binayak Road and the Nagdhunga Tunnel. Interestingly, China, which had reduced its aid to Nepal, is now financing airports and hydropower projects. Similarly, western donors have resumed their direct support for infrastructure, with the US now financing a key transmission line project.

The aid Nepal receives has always been shaped by global political dynamics. As stated earlier, modern aid began as a key component of foreign policy during the Cold War era. Although western aid broadly aims to promote development and other social agenda such as democracy, human rights, and inclusion, the politics of donor countries shape the manner in which aid and its diplomacy are enacted. As a recipient of aid from powerful countries, Nepal has historically tried to maintain a balance between competing political forces. In this, it has largely been successful, as demonstrated by the support it has received from both the US and the USSR, as well as India and China. But the global balance of power is shifting and aid is evolving accordingly. How Nepal will manage the new competitions will impact its ability to exploit the new opportunities.

### 1.3 The Objective of this Primer

This report on *aid, infrastructure, and diplomacy* is part of a series of publications by the Society of Economic Journalists-Nepal (SEJON) and the Policy Entrepreneurs Inc. (PEI) that are meant to promote an informed discourse around infrastructure and diplomacy. It has been designed as reference material for those interested in the topic of infrastructure diplomacy and consists of brief descriptions, and key observations, of the various bilateral aid of key countries, namely, the United States, the United Kingdom, Japan, China, and India. Our primary target audience is the journalists that regularly report on this and through them the general public. But we are confident that this document can be of help to anyone, from policymakers to practitioners, keen on this topic.

It is also important that we note at the very outset some of the limitations within which this report has been produced. Firstly, the time and resources that were available severely limits us to get into the specific and nuanced details of aid and its use in foreign policy. As a result of this, there may be situations where readers may have larger questions. For this purpose, we have developed an extensive reading list for each of the topics covered in this

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9 Andres, Luis Alberto, Luis Andres, Dan Biller, and Matias Herrera Dappe. "Infrastructure gap in South Asia: Infrastructure needs, prioritization, and financing." *World Bank Policy Research Working Paper 7032* (2014).

document. We recommend those interested to refer to the information there. Second, our framing for this report is based on the view that aid is an essential part of diplomacy. We acknowledge that there are other frameworks, such as aid effectiveness, through which we could examine aid. Despite these limitations, we hope that this document will contribute towards a more informed public discourse that is based on a comprehensive understanding of how aid works and how aid can work for all Nepalis.

## 2. AID: AN OVERVIEW

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This chapter provides an overview of the architecture of the global aid industry. As there are different understandings of *aid* and *why donor countries provide aid*, we begin with a thorough review of available literature on aid. We summarize efforts to establish the definition of aid and identify key historical moments in the evolution of aid.

### 2.1 Defining aid

Put simply, aid refers to funds, goods, or services transferred from a donor to a recipient country. Funds, which are the principal type of aid, can be transferred in various forms such as grants, loans, export credits, and private investments. But this general description of aid does not encompass evolving aid practices, especially as many newer countries are now entering the game. Defining what to count and what not to include is a major challenge, including from the very outset when aid, in the form that we know of today, was being conceived.

One of the first institutions that tried to bring some clarity in this regard was OECD's Development Assistance Committee (DAC). Established in 1960, DAC served as a forum where major donors discussed issues related to aid.<sup>10</sup> DAC spent much of the 1960s trying to reach a consensus on what constitutes aid. A key topic of discussion was the concessionality of loans. It did not take long for the forum to agree that export credits would not be part of aid. But the issue of untying aid generated a lot of debate.<sup>11</sup> In 1969, after almost a decade of deliberation, the DAC finally came up with some official definitions of aid.<sup>12</sup>

The key concept was the Official Development Assistance (ODA). In order to be categorized as ODA, financial assistance has to meet a number of criteria: funds must come officially from the donor government; the recipient country must be on the DAC List of Recipients of ODA; the interest rate on the financial assistance must be lower than the market rate, and the assistance must be used for the development of the recipient country. Earlier ODA included the full-face value of the loan. In 2018, the DAC updated its method of calculating ODA, which now includes only the "grant portion" of the loan.

It is widely accepted that donor countries should raise ODA to 0.7 percent of their gross national income (GNI). This target was established after a lot of deliberation and much

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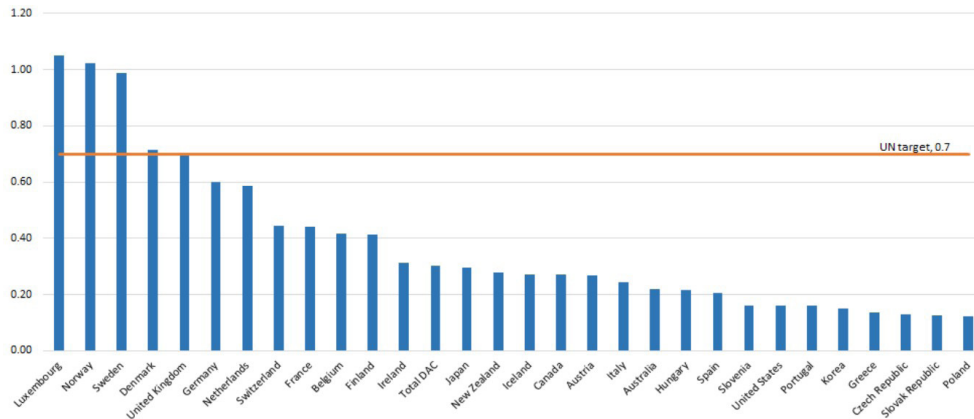
10 This forum was originally called the Development Assistance Group and was under the Organization for European Economic Co-operation and was subsequently changed to DAC when the OEEC was transformed into the OECD.

11 In more recent times, the inclusion of in-donor refugee costs as part of ODA is becoming controversial.

12 The OECD also keep record of Private Flows, which are defined as "financial flows at market terms financed out of private sector resources (changes in holdings of private, long-term assets held by residents of the reporting country) and private grants (grants by non-government organizations, net of subsidies received from the official sector)."

lobbying from developing countries.<sup>13</sup> Today even the UN uses it as its benchmark. However, despite accepting it as a “simple, attainable, and adequate”<sup>14</sup> target, most donor countries have not lived up to their commitment.

### ODA Grant Equivalent, 2019



Source: OECD/DAC data

One characteristic of ODA that has been controversial from the very beginning is the tying up of aid, i.e., requiring recipient countries to purchase goods and services from the donor country. Proponents of *tyed aid* argue that this is a means of garnering support for aid from their constituencies.<sup>15</sup> Critics, on the other hand, state that tying up of aid increases the cost of aid by 15-30 percent.<sup>16</sup> After three decades of discussion on this topic, in 2001, the donors pledged to end this practice, as recommended by the DAC.<sup>17</sup> As a result, in 2017, it is reported that 80.9 percent of the bilateral ODA<sup>18</sup> is untied.<sup>19</sup>

Another important concept associated with aid was Other Official Flows (OOF). OOF is financial assistance that does not meet the above-mentioned ODA criteria. It includes bilateral financial assistance with less than 25 percent grant element. It also includes other types of assistance that are more commercial in nature, such as grants for commercial purposes and export credits.<sup>20</sup>

13 The Pearson Commission also supported this target but kept it at 0.70 per cent of each aid-giver’s gross GNI.

14 Clemens, M. A., and Todd J. Moss. “Ghost of 0.7%: Origins and Relevance of the International Aid Target- Working Paper 68.” *Washington, DC: Center for Global Development*. (<http://www.cgdev.org/publication/ghost-07-origins-and-relevance-international-aid-target-working-paper-68>) (2005).

15 “OECD At 50: Better Policies For Better Lives - OECD”. 2022. *Oecd.Org*. Accessed January 22, 2022. <https://www.oecd.org/general/oecd50betterpoliciesforbetterlives.htm>.

16 *Ibid.*

17 *Ibid.*

18 Portions covered by the DAC recommendations

19 When we discussed untied aid in this report, it will be those that are covered by the DAC recommendation

20 OECD (2021), “Other official flows (OOF)” (indicator). Accessed January 22, 2022. <https://doi.org/10.1787/6afef3df-en>.



## 2.2 Motivations for Aid

In the aftermath of WWII, the role of aid gained importance in international policy discourses due to three phenomena. The first was the gradual end of the colonial era and the colonial powers' desire to maintain some influence over their former colonies. As far back as the 1920s, the European colonizers had begun shifting their governance paradigm, moving away from complete exploitation of the colonies and building relations, and making investments that might also benefit the colonies, even if marginally. For example, in 1921 the French government launched a program that aimed to make some improvements in their colonies.<sup>21</sup> This trend became more pronounced after WWII as colonial governments decided to take up more responsibilities in their colonies. As an increasing number of colonies gained independence in the 1950s, the European powers decided to provide aid to former colonies and other countries that had never been colonized.<sup>22</sup> Such colonial relationships continue to this day – France directs a large share of its aid to Francophone Africa, just as Britain does to the Commonwealth countries.

The second phenomenon that shaped the discourse on aid was the fear among Western countries of a potential rise of communism. This was true even in major European countries such as France and Italy where communist parties had significant support and in the UK where the Labor Party's socialist politics was quite popular.<sup>23</sup> But this threat, it was believed, was especially high in poorer countries where poverty would magnify the appeal of communism. To combat the threat of communism, it would be necessary to provide aid for the development of such countries.<sup>24</sup> But both sides of the Cold War rivalry made use of foreign aid (along with diplomatic support and military interventions) to draw countries within their sphere of influence.<sup>25</sup> In response, a number of countries established the Non-Aligned Movement (NAM) that sought to “create an independent path in world politics that would result in member States becoming pawns in the struggles between the major powers.”

The third phenomenon was the dominance of the modernization theory in the 1950s. According to this theory, societies go through various stages of development, starting at the traditional stage<sup>26</sup>, then going through social transformation and achieving economic growth and progress before becoming modern.<sup>27</sup> The catalyst for this transition, in this view, is technology and higher factors of production,<sup>28</sup> which developed nations

21 Pacquement, Francois. “How Development Assistance from France and the United Kingdom Has Evolved: Fifty Years on from Decolonisation.” *International Development Policy/Revue internationale de politique de développement* 1 (2010): 51-75.

22 Barder, Owen Matthew. “Reforming development assistance: Lessons from the UK experience.” *Center for global development working paper* 70 (2005).

23 Griffin, Keith. “Foreign Aid after the Cold War.” In *Studies in Globalization and Economic Transitions*, pp. 34-71. Palgrave Macmillan, London, 1996.

24 OECD. “The OECD at 50: Development co-operation past, present and future”, in Development Co-operation Report 2011: 50th Anniversary Edition, <https://doi.org/10.1787/dcr-2011-7-en>. Paris, France. OECD Publishing, 2011.

25 Strydom, Hennie. “The Non-Aligned Movement and the reform of International relations.” *Max Planck Yearbook of United Nations Law Online* 11, no. 1 (2007): 1-46.

26 The underdeveloped nations were considered to be at the earlier stages of development and the developed nations towards the latter stage.

27 Krasner, Stephen D. “Foreign aid: Competing paradigms.” *Journal of Intervention and Statebuilding* 5, no. 2 (2011): 123-149.

28 Ibid.

would provide to poorer countries in the form of aid. This line of thinking dominated policymaking to such an extent that US President Truman, in his inauguration speech, stated that the US should share its scientific advances and industrial progress to improve the “*underdeveloped areas*.”

Contrary to widespread belief, foreign aid is motivated by neither pure altruism nor pure self-interest. In reality, donors often try to find a balance between these two motives in their decisions.<sup>29</sup> In this paper, we examine the self-interest motives of Western donors and China while acknowledging that the aid they provide serves purposes beyond mere self-interest.

## 2.3 Key Moments in the Evolution of Aid

With the emergence of China as a major donor, we have entered a new phase of development aid. Unlike other new donor countries, China is trying to forge its own path rather than join the existing international aid system. To place these new dynamics in context, the next section looks at how aid has evolved over the last seven decades.

### Golden Era (1950s–1960s)

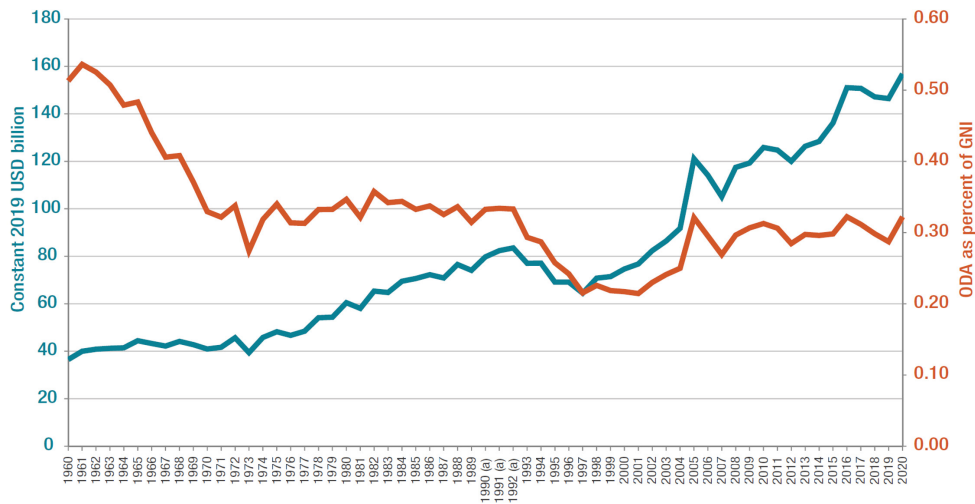
The fifties and sixties were the golden eras for aid. In the heady days after the war’s end, the western countries saw aid as a foreign policy tool for shaping the future of the world. This was driven partly by a desire to advance their political ideology amid the growing Cold War rivalry, and partly by the moral imperative to help the lesser developed countries. To see this through, these countries began institutionalizing their national aid infrastructure. For example, in 1960, Canada established its External Aid Office (later changed to the Canadian International Development Agency (CIDA)). In the following years, other countries set up their own aid agencies – the French Ministry of Cooperation; the United States Agency for International Development (USAID); the German Ministry for Economic Cooperation; and Japan’s Overseas Economic Cooperation Fund, among many others.

Concurrently, the west also created several multilateral institutions, namely the United Nations (UN) and the Bretton Woods institutions such as the World Bank (WB) and International Monetary Fund (IMF). All these institutions were mandated to promote economic growth and social well-being in developing countries.<sup>30</sup> To that end, the World Bank set up the International Development Association (IDA) in 1960 to provide soft loans to developing countries. In 1961, the UN designated the 1960s as the UN Development Decade and urged donor nations to increase their development assistance to approximately one percent of their national income. The OECD also established the Donor Assistance Group, which adopted the Resolution on Common Aid Effort in 1961.

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29 Gulrajani, Nilima, and Rachael Calleja. “Understanding donor motivations: developing the Principled Aid Index.” (2019).

30 United Nations. 2022. “Preamble | United Nations”. United Nations. Accessed January 22, 2022. <https://www.un.org/en/about-us/un-charter/preamble>.



(a) Total DAC excludes debt forgiveness of non-ODA claims in 1990, 1991 and 1992.

Source: The DAC - 60 Years, 60 Highlights - OECD

The institutionalization of the aid apparatus was, however, not limited to the state level. An increasing number of non-governmental entities were also established during this period, and these would play an important role in shaping the global agenda on development assistance.

### Changing Paradigm (1970s–1980s)

The public perception of aid had begun to change by the early 1970s. This shift was driven primarily by the lack of desired development outcomes. Despite receiving millions of dollars, many developing countries had not been able to overcome their development challenges and transition adequately into more modern societies. There were growing discussions about how to make aid more effective. It was then agreed that what poorer countries needed was not just the transfer of capital and technology but also investments in building human capital and targeted institutional reforms that supported development.

One event of the 1980s that had a big impact on aid was the default on sovereign loans by a number of countries.<sup>31</sup> In response to this debt crisis, the western donors, led by the World Bank and the International Monetary Fund, came up with their *structural adjustment loan* programs. This approach was based on the idea that poorer countries must embrace free markets to achieve economic growth and development.<sup>32</sup> These loans came with strict conditions whereby recipient countries had to adopt a set of neoliberal policy reforms that became known as the Washington Consensus. These reforms included liberalization of the domestic market, the deregulation of goods and the capital market, and privatization of state-owned enterprises.<sup>33</sup>

31 “Chapter III: The End Of The Golden Age, The Debt Crisis And Development Setbacks”. 2022. UN.Org. Accessed January 22, 2022. <https://bit.ly/32mZ4A5>.

32 Babb, Sarah. “The social consequences of structural adjustment: recent evidence and current debates.” *Annu. Rev. Sociol.* 31 (2005): 199-222.

33 World Bank. *World Bank Operation Manual*, Statement 3.58, Annex II. November 1982.

### Newer Drivers (1990s–2000s)

In the early nineties, the collapse of the USSR brought an end to the Western countries' primary rationale for aid, i.e., to counter communism.<sup>34</sup> The new global political order brought a shift in the donor countries' priorities, as many began focusing on the newly created states in Eastern Europe. These countries were seen to be politically more fragile and closer to home, and the goal was to help them transition into stable liberal economic and political systems.<sup>35</sup> The fall of the USSR also meant that developing countries now had to rely almost entirely on Western countries for financial assistance. As a result, the west showed that they were becoming bolder in terms of their aid conditions, especially around democracy and governance.<sup>36</sup>

Another major event that impacted foreign aid was the attack on the US on September 11, 2001. In the aftermath of the event, national security became an overriding concern to western donors, especially the United States. Consequently, foreign aid began incorporating elements of security as a key component of development programs.<sup>37</sup> This was meant to reward those who allied with the west in the fight against terrorism. Indirectly, this was also meant to help tackle the issue of poverty, which weakens the capacity of the state to stop the growth of terrorist networks.<sup>38</sup>

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34 Griffin, Keith. "Foreign Aid after the Cold War." In *Studies in Globalization and Economic Transitions*, pp. 34-71. Palgrave Macmillan, London, 1996.

35 Williams, David. "The history of international development aid." In *Handbook of Global Economic Governance*, pp. 233-248. Routledge, 2013.

36 Mearsheimer, John J. "The gathering storm: China's challenge to US power in Asia." *The Chinese journal of international politics* 3, no. 4 (2010): 381-396.

37 Miles, W. 2013. Deploying Development to Counter Terrorism: Post-9/11 Transformation of U.S. Foreign Aid to Africa.

38 Brainard, Lael. "US Foreign Assistance After September 11: Major Changes, Competing Purposes and Different Standards—Is There an Overall Strategy?." *Testimony, Committee on International Relations, US House of Representatives* (2004).

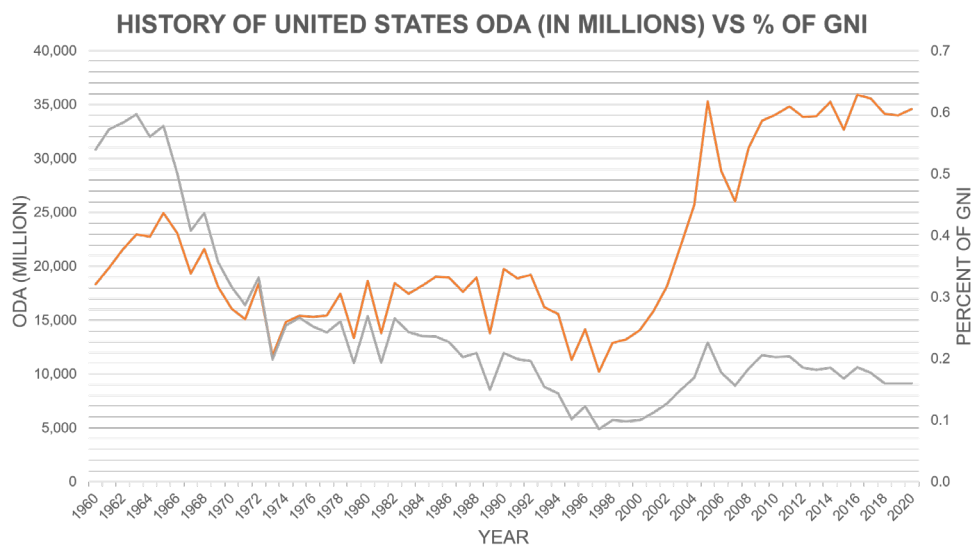
## 3. THE DONORS

This section looks at the aid practices of five donor countries – the US, the UK, Japan, China, and India. These countries were selected for different reasons. The US and China are two great powers, and the growing competition between them will likely have huge ramifications for the future of aid. The UK and Japan are two of the four largest DAC donor countries, with a history of infrastructure diplomacy relevant to Nepal. India occupies a hegemonic position in South Asia and has a longstanding bilateral relationship with Nepal, infrastructure development being a major component of it.

### 3.1 United States

#### American Aid at a Glance

The US has consistently been the largest DAC donor by volume. In 2020, it disbursed USD 35.5 billion, accounting for 22 percent of the total ODA that year. This contribution, however, accounts for only 0.17 percent of its GNI, placing it 24th among all DAC donors in terms of the ODA-to-GNI ratio.



Africa receives the largest share of US assistance; in 2018 it received USD 11 billion. Asia comes second at USD 7 billion, of which about half was allocated to the Middle East. Afghanistan and Jordan were the highest recipients of US ODA in 2018-2019, at USD 1.2 billion and USD 1.1 billion, respectively. A large portion of American aid – 27.1 percent in 2018 – was allocated to the education, health, and population sectors, followed by humanitarian aid at 26.5 percent. A meager 4.1 percent of US aid was allocated for economic infrastructures.

## A Brief History of American Aid

America's first aid program was the European Recovery Program, popularly known as the Marshall Plan. It is known to have ushered in the modern era of foreign aid. Implemented from 1948 to 1951, the Plan aimed to help rebuild post-war Europe through various kinds of technical and financial assistance.<sup>39</sup> Another major underlying rationale of the Plan was to prevent the spread of communism in Europe, at a time when its weak economic conditions were seen to provide fertile ground for the rival ideology.<sup>40</sup> The overall plan cost the US over USD 13 billion.<sup>41</sup> While America had been providing loans to Europe, this contribution was in the form of grants. Despite some initial opposition, the Plan is now considered one of the most successful aid programs and has served as an overall template for foreign aid.

However, as the US was drawn deeper into the Cold War rivalry with USSR, it began to orient its aid towards military security.<sup>42</sup> For example, in 1951, the US signed the Mutual Security Act, allocating USD 7.5 billion to fight against what State Secretary Acheson called Soviet "encroachment" into Western Europe.<sup>43</sup> This attitude to aid changed in the subsequent administration of President Eisenhower, who began his term as a skeptic of aid.

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39 These efforts included the increase of agricultural and industrial production, the restoration of sound budget and financial systems, and the stimulation of trade within Europe and with the rest of the world.

40 Schmitz, David F. *The United States and right-wing dictatorships, 1965-1989*. Cambridge University Press, 2006.

41 Tarnoff, Curt. *The Marshall plan: Design, accomplishments, and significance*. Vol. 18. Congressional Research Service, 2018.

42 Ibid.

43 "The Mutual Security Act Of 1951 | US House Of Representatives: History, Art & Archives". 2022. *History.House.Gov*. Accessed January 22, 2022. <https://history.house.gov/Historical-Highlights/1951-2000/The-Mutual-Security-Act-of-1951/>.

**SOVIET AID**

The USSR, America's Cold War rival, used foreign aid as an important tool for countering western influence in the developing countries of the "third world" and for promoting socialist state-planned economy across the globe. In the early 1950s, the Soviet government emphasized foreign aid and other trade-linked economic infiltration as a means through which developing countries could "peacefully transition" to socialism. Countries received Soviet aid based on their ideological inclination and geostrategic significance. Soviet aid held a special appeal for countries engaged in struggles for independence from colonialism. For them, Soviet partnership served two purposes: it supported their post-colonial symbolic positioning and provided them with financial resources to build their economies. As a result, many countries such as Afghanistan, India, Turkey, Indonesia, Egypt, and Ghana, among many others, received large allocations of Soviet aid.

Soviet aid came mostly in the form of low-interest line-of-credit with a long repayment period. It was usually tied to the acquisition of Soviet equipment, machinery, and technical assistance for large, highly visible public sector infrastructure or industrial projects, such as the Aswan Dam in Egypt and the Bokaro Steel Plant in India. Another appealing feature of Soviet aid was that recipient countries could use it to resolve their balance of payment issues. Interestingly, countries that accepted Soviet aid were also its major trade partners. The total trade turnover in these recipient countries grew from around USD 241 million in 1955 to USD 1,936 million by 1965, signaling their growing dependence on the USSR.

By the late 1960s, the USSR was providing aid to many countries including the newly independent countries in Africa, Asia, and Latin America. This had dramatically increased the country's aid burden and raised concerns about aid sustainability and increasing competition from Western aid. The USSR realized that aid alone could not guarantee the desired levels of influence. At the same time developing countries' attitude towards Soviet aid was changing. Many recipient countries that had begun to industrialize found Soviet machinery and technology to be of poor quality. In response, the Soviets gradually revised their strategy, emphasizing strategic economic assistance coupled with military support. The latter included arms deals, training of officers in the USSR, and military advice.

American foreign aid architecture received a major upgrade in 1961 with the passing of the new Foreign Assistance Act. The key figure behind this was President Kennedy, an ardent proponent of aid, who also lobbied allies such as Germany and Japan to increase their aid. The Act helped streamline aid-related tasks spread across multiple agencies and brought some coherence to the scattered objectives of US foreign aid.<sup>44</sup> The legislation also established USAID, a semi-autonomous agency under the Department of State (DoS) whose administrator reported directly to the President. This new agency was responsible for the economic portion of American aid, which would be disbursed in the form of development funds and technical assistance.

But there were plenty of critics of American aid, particularly in the conservative faction of US politics. They highlighted wastefulness associated with aid, elite capture of funds meant for the poor, and aid's counterproductive role in bringing the desired changes by supporting governments in need of reform.<sup>45</sup> These critics proposed all kinds of methods for overhauling the American aid system – replace USAID with another agency; ensure that funds provided to developing countries are in proportion to their own contribution; channel the larger portion of American aid through multilateral banks; separate development aid from military aid.<sup>46</sup>

In the 1970s, two trends in the aid policy discourse impacted American aid.<sup>47</sup> The first was the increased focus on the development aspect of aid, which was partly a result of the changing definitions of the purpose of aid within the development community. The US Congress passed legislation shifting the focus of American aid towards fulfilling the “basic human needs” of recipient countries. To that end, efforts would be made to target poorer countries and invest in areas such as health, education, and agriculture.<sup>48</sup> The second trend involved the US, led by President Carter, expressing commitment to human rights.<sup>49</sup> Countries' performance on human rights became criteria for receiving American aid, albeit used with a degree of flexibility.

The volume of American aid fell drastically in the early 1990s. This was primarily because the end of the Cold War made the rationale of fighting communism through aid obsolete. Further, President Clinton emphasized cutting the federal budget deficit, where aid as a “discretionary program” was a relatively easy target.<sup>50</sup> As a result, American aid decreased from USD 19.7 billion in 1990 to its historic low of USD 10.2 billion in 1997. However, during this post-Cold War period, the US did make efforts to assist the newly independent Eastern European countries in transitioning towards democracy. In fact, the promotion of democracy became one of the key stated goals of American aid,<sup>51</sup> a goal supported by both

44 Dechert Law Firm for Oxfam America, *A SUMMARY OF U.S. FOREIGN ASSISTANCE LEGISLATION*, December 2008.

45 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

46 Peterson, Rudolph A. *US foreign assistance in the 1970s: a new approach: report of the president from the task force on international development, March 4, 1970*. US Government Printing Office.

47 Sartorius, Rolf H., and Vernon W. Ruttan. “The sources of the basic human needs mandate.” *The Journal of Developing Areas* 23, no. 3 (1989): 331.

48 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

49 Windsor, Jennifer. “Democracy and Development: The Evolution of US Foreign Assistance Policy.” *Fletcher F. World Aff.* 27 (2003): 141.

50 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

51 Windsor, Jennifer. “Democracy and Development: The Evolution of US Foreign Assistance Policy.” *Fletcher F. World Aff.* 27 (2003): 141.



the American bureaucracy and the development community. The former saw democracy as inseparable from human rights; the latter saw it as a precondition for development. This new goal of American aid also gained credence among academic circles. Democracies do not go to war with each other, it was said, and promoting democracy globally would help bring peace and stability to the world.<sup>52</sup>

America was forced to rethink its aid following the attack of September 11, 2001, on American soil. In the aftermath of the event, the Bush administration mentioned aid as one of the three pillars of American foreign policy, the other two being defense and promotion of democracy abroad.<sup>53</sup> America increased its foreign aid at an unprecedented rate and established a new aid institution, the Millennium Challenge Corporation (MCC). Some view this willingness to provide more aid as the Bush administration's strategy to balance its more militaristic and unilateralist approach.<sup>54</sup> American aid also swelled due to the post-war rebuilding efforts in Afghanistan and Iraq: USAID's fund grew from USD 36 million in 2001, to USD 1.2 billion in 2004, and to US 2.6 billion in 2010. Likewise, in Iraq, in 2003 and 2004, the US spent USD 4.5 billion. By then, American aid had reached an all-time high of USD 35.3 billion. Although the US involvement in these countries has decreased, US aid continues to hover around historic highs.

## Key Observations of American Aid

**Institutional Architecture of American Aid:** While USAID is the primary agency for implementing American aid, there is a range of executive agencies that also implement their own programs. Of these, the Department of Defense and the Department of State are the largest agencies, but others such as the Department of Agriculture, the Department of Health and Human Services (DHHS), the Millennium Challenge Corporation, and a host of other smaller agencies all implement aid programs.

USAID has the task of balancing the two aspects of American aid – development, and diplomacy. While its performance is evaluated based on its development goals, it is also responsible for certain diplomatic roles, and the two do not always overlap.<sup>55</sup> In the past, there have been attempts to merge USAID into the State Department, with the latter exerting more control over aid to meet its foreign policy objectives.<sup>56</sup> USAID has managed to resist thus far, stating that such a merger would compromise its development objectives.<sup>57</sup> More recently, President Biden has elevated the role of the USAID Administrator to a permanent member of the National Security Council, which indicates that his administration views development aid as a key pillar of his foreign policy.

The establishment of the Millennium Challenge Account in 2004, and MCC as its implementing agency, was a novel approach to aid delivery. This was partly a response to criticisms leveled against traditional aid. Recipient countries would now be selected through a competitive process, and evaluated against 16 indicators spread across three broad

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52 Kant, Immanuel. "Democratic peace theory."

53 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

54 Ibid.

55 Ibid.

56 Lancaster. *United States: Morgenthau's Puzzle*. 87.

57 Ibid.

categories, namely governing justly, investing in people, and promoting economic freedom. Also, MCC not only promoted ownership but also targeted evidence-based interventions, as recipient countries were allowed to pick projects of their choice and invest in them after the project went through a rigorous process of evaluation and public consultation. Quite uniquely, MCC offered to build these projects through grants and there was a pledge to insulate the funds from becoming directly influenced by the strategic foreign policy of the US. By 2020, MCC had made investments of over USD 9 billion in 28 countries.<sup>58</sup> While the agency is not required to invest in hard infrastructure, MCC has invested about 25 percent in transport and 19 percent in energy infrastructure.<sup>59</sup>

The Overseas Private Investment Corporation (OPIC) is another institution established by Foreign Assistance Act with the mandate to serve as America's primary development finance institution. OPIC has been providing finance, particularly infrastructure funding, and its overall exposure in 2017 was USD 23.2 billion. That year OPIC reportedly authorized commitments of USD 3.8 billion and helped mobilize a total of USD 6.8 billion from private capital.<sup>60</sup> In 2018, the US Congress passed the Better Utilization of Investments Lending to Development Act (BUILD Act), to establish the U.S. International Development Finance Corporation (DFC). This agency would succeed OPIC, but have expanded authority and inherit the functions of other agencies such as the Development Credit Authority of USAID. Most notably, it would double its exposure cap from USD 29 billion to USD 60 billion. The primary rationale behind DFC was "to provide countries a robust alternative to state-directed investments by authoritative governments ... using best practices with respect to transparency and environmental and social safeguards, and which take into account the debt sustainability of partner countries."<sup>61</sup> Although the legislation does not mention specific countries, it is clearly intended to counter Chinese influence. DFC was launched in 2019 and in its first year of operation, it reported having "committed USD 4.6 billion to projects that are expected to mobilize an additional USD 6.8 billion in private capital."<sup>62</sup>

**Drivers of American Aid:** The main driver for American aid is America's concern for national security.<sup>63</sup> During the Cold War, America saw communism and the Russian state as the threat to the "American way of life". America used aid as a broader foreign policy tool for winning allies over to its side. In the early nineties, after the Soviet Union collapsed and America emerged as the only superpower, the focus of American aid shifted from technical assistance and human capital to issues of democracy and governance. In the post 9/11 phase, the threat to America's national security was international terrorism. With the rise of China in recent decades, many in Washington have tried to portray China as a direct threat to America. Even those who do not see China as a direct threat agree that China is a competitor that must be dealt with immediately. America, therefore, seems to be realigning its aid to counter this perceived threat.

58 "Report: 2020 Annual Report". 2022. *Millennium Challenge Corporation*. Accessed January 22, 2022. <https://www.mcc.gov/resources/pub-full/annual-report-2020#section-ar-2020-introduction>.

59 "Report: Congressional Budget Justification, FY 2022". 2022. *Millennium Challenge Corporation*. Accessed January 22, 2022. <https://www.mcc.gov/resources/pub-full/cbj-fy2022#story-cbj-fy2022-appendix>.

60 Akhtar, Shayerah Ilias, and Marian L. Lawson. "BUILD Act: Frequently Asked Questions About the New US International Development Finance Corporation." *Congressional Research Service*, January 15 (2019): 4.

61 Ibid.

62 "DFC | Investing in Development." *U.S. International Development Finance Corporation*. Accessed January 22, 2022. [https://www.dfc.gov/sites/default/files/media/documents/DFC\\_2020\\_Annual\\_Report.pdf](https://www.dfc.gov/sites/default/files/media/documents/DFC_2020_Annual_Report.pdf).

63 Lawson, Marian L., and Emily M. Morgenstern. "Foreign aid: An introduction to US programs and policy." *Congressional Research Service Report* 40213 (2019).

The second driver of American aid is the role that America has given itself. Americans believe that the liberal order America epitomizes is the ultimate form of human government. In this view, America has the responsibility for promoting development and democracy in other countries, both to serve its interests and to bring peace and stability to the world. We should note that the promotion of democracy did not feature in the initial days of US foreign aid.<sup>64</sup> By the 1980s, some aid programs did mention the promotion of democracy as one of their objectives but this was overshadowed by the larger goal of countering Soviet influence. Things changed in the 1990s in the wake of the Cold War. The US government, backed by legislations such as the Eastern European Democracy Act and the Freedom Support Act, launched programs with the primary objective of promoting democracy and free markets. By this time, the US government had taken to heart the principles of liberal democracy that saw a direct positive correlation between democracy and development.<sup>65</sup>

The non-governmental constituencies<sup>66</sup> play a critical role in influencing American aid. The role of these institutions has been quite effective at times, one of the best examples being its campaign to stop the cuts in aid during the 1990s.<sup>67</sup> In 2018, the US channeled about USD 6.8 billion, equivalent to about 22 percent of its gross bilateral ODA, through civil society organizations. The commercial sector, however, has relatively limited involvement in American aid,<sup>68</sup> primarily because the aid volume pales compared to the commercial transaction of US companies.<sup>69</sup>

## 3.2 United Kingdom

### UK Aid at a Glance

In 2019, the UK was the third-largest contributor of ODA, which amounted to around USD 19.5 billion.<sup>70</sup> With this contribution, the UK fulfilled its ODA-to-GNI ratio commitment of 0.7 percent, making it the only G7 country to achieve the intended target. Two-thirds of UK ODA was channeled bilaterally, most of which, i.e., 72.3 percent, was allocated through the erstwhile Department for International Development (DFID). The remaining one-third was channeled through multilateral institutions, of which the EU and the World Bank were the largest recipients, at USD 2.3 billion and USD 1.2 billion, respectively. Other multilateral institutions such as the Global Fund to Fight Aids, Tuberculosis and Malaria; and Gavi, the Vaccine Alliance also received USD 472 million and 51 million, respectively. Several UN agencies also received funds such as the Central Emergency Response Fund (USD 383 million), UN Development Fund (USD 70 million), and the World Food Program (USD 51 million).<sup>71</sup>

64 Windsor, Jennifer. "Democracy and Development: The Evolution of US Foreign Assistance Policy." *Fletcher F. World Aff.* 27 (2003): 141.

65 Fukuyama, Francis. "The End of History and the Last Man (New York, 1992). See also Otis Graham," "Premature Reports of the 'End of History,'" *Organization of American Historians, Newsletter* 3 (1990): 23.

66 This includes the private sector contractors who deliver development.

67 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

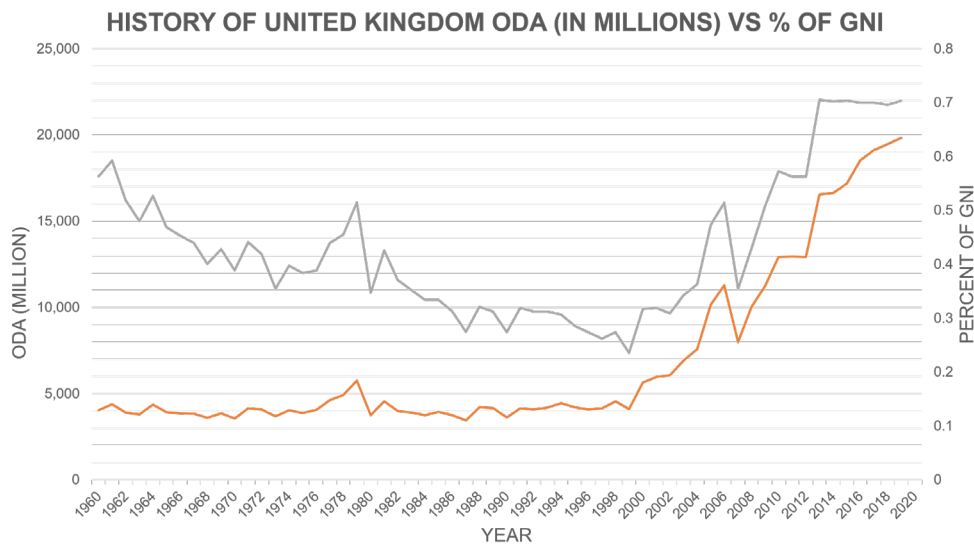
68 There is an exception though the agriculture sector. As a result, food aid constitutes a major portion of US aid.

69 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

70 While the UK government has provided 2020 figures, here we refer to the 2019 figure given all of the institutional changes that were made in 2020.

71 Development, Department for International. "Statistics on International Development: Provisional UK Aid Spend 2019." GOV.UK. GOV.UK, April 7, 2020. <https://www.gov.uk/government/statistics/statistics-on-international-development-provisional-uk-aid-spend-2019>.

The largest share of the UK’s bilateral ODA – 15 percent in 2019 – was allocated for humanitarian assistance. This was followed by investments in global health, which accounted for another 14 percent of the total UK ODA. Whereas the UK spends very little of its bilateral ODA on economic infrastructure, it does so at a significantly higher percentage of the ODA that it provides through multilateral organizations. Geographically, the UK has had a strong focus on Africa and Asia; in 2018, it allocated USD 3.9 billion and USD 3 billion for these continents, respectively, which account for 31 percent and 24 percent of its total bilateral ODA.<sup>72</sup> In 2019, Afghanistan, Pakistan, and Ethiopia were the largest recipients of UK ODA.



### A Brief History of UK Aid<sup>73</sup>

UK’s earliest aid initiative dates back to 1929 with the Colonial Development Fund, a £1 million annual allocation to support agriculture and industries in its colonies. This fund was, however, not fully meant for the colonies; its stated intention was to reduce unemployment in the UK by promoting industries and trade. Furthermore, the recipient countries were not allowed to spend the fund on social services or on projects that did not ensure direct gains for the UK.<sup>74</sup> In 1940, in an attempt to quell the social unrest in its colonies, the UK government modified this arrangement, raising the fund to £5 million and allowing the recipient countries to invest it in the social sectors.

After WWII, the newly elected government resolved to bring development to its colonies. It passed key legislations for increasing financial aid and established the Colonial Development Corporation and the Overseas Food Corporation to “bring about a speedier and more widespread development of our territories overseas for the benefit of the Colonial peoples,

72 “DAC Member Profile: United Kingdom.” OECD. Accessed January 22, 2022. <https://www.oecd.org/dac/unitedkingdom.htm>.

73 Most of this historical part of UK aid relies on the Barder (2005). *Reforming Development Assistance: Lessons from the UK Experience*. Center for Global Development.

74 Barder, Owen Matthew. “Reforming development assistance: Lessons from the UK experience.” *Center for global development working paper 70* (2005).

whose low standard of living can be raised by greater use of their natural resources.”<sup>75</sup> In 1958, the government expanded its aid to former colonies as well as to countries it had never colonized. Given the success of the Marshall Plan, the UK used it as a template, providing aid in the form of grants, concessional loans, and technical assistance.<sup>76</sup>

The UK government began further institutionalizing its aid infrastructure in the 1960s. By then the government believed economic development was necessary for lifting poor countries out of poverty and that aid had an integral role in it. It established the Department of Technical Cooperation, which would later become the Ministry of Overseas Development (MOD).<sup>77</sup> MOD’s first White Paper on aid, published in 1965, stated that the UK had a moral duty to provide aid and that it would serve the UK’s long-term interest. MOD’s position in the government, however, would fluctuate over time. When the Conservative Party was in power, MOD was downgraded into a department within the Foreign and Commonwealth Office (FCO). It faced an existential crisis as the Conservatives held power for almost a decade and a half during which aid was defined largely as a tool for promoting the UK’s commercial and foreign policy interests.

In 1997, with the Labor Party in the government, MOD was transformed into the Department for International Development (DFID) with its own full-fledged minister. In the following years, DFID played a key role in administering UK aid. In 2013, it accounted for about 88 percent of the total ODA disbursed by the UK. This figure decreased in subsequent years, going down to 80 percent in 2015,<sup>78</sup> 74.2 percent in 2018,<sup>79</sup> and 73.2 percent in 2019.<sup>80</sup> Other agencies such as the Department for Business, Energy, and Industrial Strategy, the FCO, and the Conflict, Stability and Security Fund were allocated 6.3 percent, 4.5 percent, and 4.4 percent of the 2019 ODA, respectively. Nevertheless, DFID earned a reputation as a global leader in the international development sector and “a model for other rich countries.”<sup>81</sup> Further, the aid discourse then placed much emphasis on the development agenda. In 2015 the government passed the International Development (Official Development Assistance Target) Act, which required the UK to meet the 0.7 percent (of GNI) target for ODA.<sup>82</sup>

In 2020, the new Conservative government merged DFID with FCO to form the Foreign, Commonwealth, and Development Office (FCDO). The purported goal was to align UK’s aid initiatives with its foreign policy objectives. That same year, citing the impact of COVID-19 on the British economy, the government cut its aid budget, lowering its target to 0.5 percent of GNI. Amidst all this, the government conducted an “integrated review of (its) security, defense, development, and foreign policy.” The review report explicitly states the UK’s

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75 Ibid.

76 Ibid.

77 It would be the Overseas Development Administration under the Conservative government, but doing the same.

78 Thompson, Stephen. “International development, UK aid and Official Development Assistance spending.” (2017).

79 “DAC Member Profile: United Kingdom.” OECD. Accessed January 22, 2022. <https://www.oecd.org/dac/unitedkingdom.htm>.

80 Development, Department for International. “Statistics on International Development: Provisional UK Aid Spend 2019.” GOV.UK. GOV.UK, April 7, 2020. <https://www.gov.uk/government/statistics/statistics-on-international-development-provisional-uk-aid-spend-2019>.

81 Barder, Owen Matthew. “Reforming development assistance: Lessons from the UK experience.” *Center for global development working paper* 70 (2005).

82 In 2020, the UK government decided to temporarily decrease its funding to 0.5 percent of GNI, which it stated as the impact of the COVID pandemic on the British economy.

“change of approach” from past policies that were focused on preserving the post-Cold War ‘rules-based international system’ to ones more suited for the “international order (that) is more fragmented, characterized by intensifying competition between states over interests, norms, and values.”<sup>83</sup>

## Key Observations of UK Aid

**The Influences and Priorities of UK Aid:** While UK aid has its roots in its colonial past, it has evolved over time according to the country’s changing political realities. This is partly due to the differing values of the two primary political parties, and the issues they emphasize while in power. For example, in the 1980s, the Conservatives allocated substantial aid resources for initiatives that would promote UK’s industrial and commercial objectives.<sup>84</sup> On the other hand, in 1997, as mentioned earlier, the Labor Party established a well-endowed DFID with more emphasis on the development agenda.

In recent times, UK aid has significantly been influenced by Brexit, i.e., the UK’s decision to withdraw its membership from the EU. The current government, which pushed the Brexit agenda, is keen to project the UK as a European country with “unique global interests” and independent from the EU.<sup>85</sup> This is in addition to the UK’s desire to position itself as a powerful actor in the changing global political order. The establishment of FCDO can thus be seen as an attempt to reformulate UK’s foreign policy by incorporating aid as its key component.<sup>86</sup> Amid this transition, the future of UK aid is quite uncertain.

Security remains a high priority for the UK in the post-9/11 era. Since then, UK aid policies have focused on conflict-affected and fragile states, and it has been the most visible ally of the US in the “war on terror” and the Iraq War. Since the early 2000s, a significant part of its bilateral aid was allocated to Afghanistan, Iraq, and Pakistan.<sup>87</sup> In recent times, given the growing potential for conflict in the Indo-Pacific region and concerns around trade and security, the UK is seeking bigger engagement. Besides security, UK aid is also committed to collective action problems such as climate change and biodiversity loss.

## 3.3 Japan

### Japanese Aid at a Glance

With a contribution of USD 15.5 billion in 2019, Japan was the fourth-largest contributor of ODA. In terms of its contribution relative to GNI, Japan, at 0.3 percent of GNI, ranks thirteenth among the DAC members. Historically, Japan has provided around three-fourths of its aid bilaterally. About 23 percent is channeled through multilaterals, a share far below the OECD-

83 Office, Cabinet. “Global Britain in a Competitive Age: The Integrated Review of Security, Defence, Development and Foreign Policy.” GOV.UK. GOV.UK, July 2, 2021. <https://bit.ly/3KJQxbQ>.

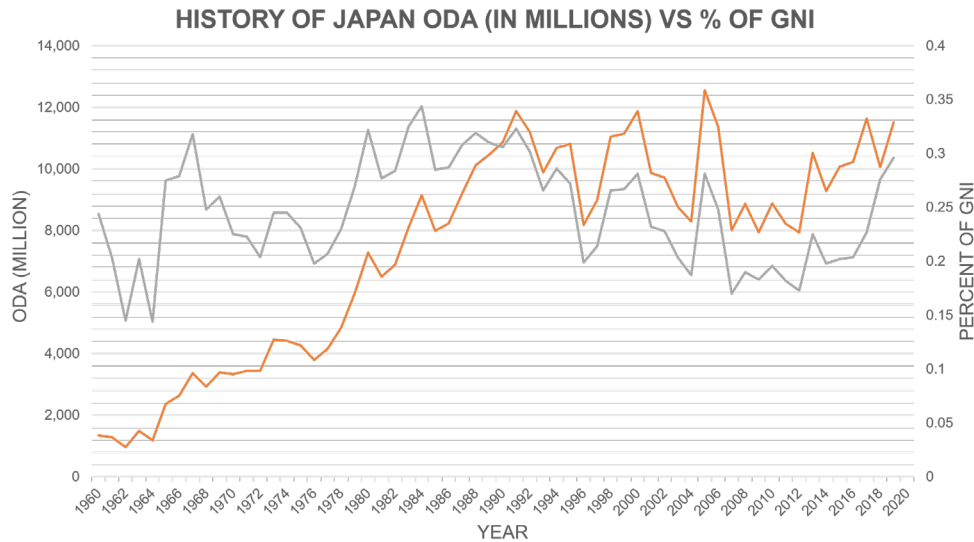
84 Barder, Owen Matthew. “Reforming development assistance: Lessons from the UK experience.” *Center for global development working paper 70* (2005).

85 Office, Cabinet. “Global Britain in a Competitive Age: The Integrated Review of Security, Defence, Development and Foreign Policy.” GOV.UK. GOV.UK, July 2, 2021. <https://bit.ly/3KJQxbQ>.

86 This, we should note, is not just in the UK, but also the case in Australia, Canada and Sweden.

87 The element of security shaping aid allocation and distribution is remarkable in UK expenditure in the wars of Iraq, where the majority of the spending came through the UK’s Ministry of Defense.

DAC average of 41%. In 2018, Japan disbursed about USD 4.5 billion, or 34.5 percent of its ODA, to the economic infrastructure sector, of which 14 percent was allocated to the energy sector alone. Japan’s bilateral aid comes mostly in the form of loans. In 2018, loans made up 60% of Japan’s bilateral ODA, which is significantly higher than the DAC average of 9%.



### A Brief History of Japanese Aid

Japan’s aid architecture is shaped by the reparations it had to pay in the aftermath of WWII.<sup>88</sup> Japan’s official aid began in 1954 when it offered technical assistance after joining the Colombo Plan.<sup>89</sup> Japan began offering concessional loans in 1958, starting with India, which used the loan to purchase Japanese goods and services.

In the 1960s, Japan began to develop a number of institutions to oversee its growing aid portfolio. For example, in 1961 and 1962, it established the Overseas Economic Cooperation Fund and the Overseas Technical Cooperation Agency to provide financial and technical assistance to developing countries.<sup>90</sup> The latter was, in 1974, merged with the Japan Emigration Service to establish the Japan International Cooperation Agency (JICA), which is the primary agency responsible for administering Japanese aid. Other major milestones included the admission of Japan into DAC in 1961 and into the OECD in 1964.

Japan’s aid was significantly impacted by the “Fukuda Doctrine”. During his 1977 tour of Southeast Asia, Prime Minister Fukuda gave a speech expressing Japan’s commitment to peace. He said Japan would operate as an economic power rather than a military power and build a strong, cooperative relationship with Southeast Asian countries.<sup>91</sup> Thereafter Japan began to increase its bilateral assistance to the region. Another major influence on

88 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.  
 89 Established in 1950, the Colombo Plan was an arrangement established by the UK government to develop the human resources of the Asia Pacific region.  
 90 Shimomura, Yasutami, John Page, and Hiroshi Kato, eds. *Japan’s development assistance: Foreign aid and the post-2015 agenda*. Springer, 2016.  
 91 Yano, Toru. *The “Fukuda Doctrine” and Its Implications for Southeast Asia*. ISEAS Publishing, 1978.

Japan's decision to increase its bilateral assistance was US pressure on Japan to do more in the area of economic cooperation.<sup>92</sup> Japan's ODA doubled in 1977, and by 1989 it had become the largest donor by volume. It was also aligning its bilateral assistance with the strategic interest of the US. Another key development toward the end of the 1970s was Japan's assistance to China, which continued for about four decades, until 2018.<sup>93</sup> Japanese aid to China during this period amounted to about USD 32.52 billion, mostly in the form of low-interest loans.

Japan's aid declined in the 1990s owing to domestic financial problems. It did, however, make its biggest contribution of over USD 80 billion in 1998, in the aftermath of the Asian Financial Crisis, to support the hard-hit Southeast Asian economies. The Japanese government drew a lot of public criticism for doling out large volumes of aid when the country was struggling financially.<sup>94</sup> To make matters worse, several high-profile corruption cases were (allegedly) tied to Japanese aid, which further reduced public support for the cause.<sup>95</sup> In response, the government undertook a number of reforms. It realigned its aid institution, converting JICA into an *independent administrative institution*, thus giving the agency more autonomy; it also merged the ODA loan department of its export credit agency, i.e., the Japan Bank of International Cooperation (JBIC), into JICA, allowing it to handle all three mechanisms of foreign aid, i.e., technical cooperation, grants, and loans.<sup>96</sup>

Since 2010, Japanese aid has kicked back into high gear, with a greater focus on infrastructure. In 2015, it partnered with the Asian Development Bank to launch the *Partnership for Quality Infrastructure* initiative with an investment target of USD 110 billion, for building "quality infrastructure projects" in Asia within five years. One year later, it added another USD 200 billion into the initiative. Amid China's rise as the biggest power in Asia, Japan is trying to position itself as the best alternative by focusing on issues that might potentially attract recipient governments. In 2015, Japan outlined its five Principles of Promoting Quality Investment – *Ensuring effective governance, reliable operation, and economic efficiency in view of life-cycle cost as well as safety and resilience against natural disaster, terrorism, and cyber-attack risks; Ensuring job creation, capacity building and transfer of expertise and know-how for local communities; Addressing social and environmental impacts; Ensuring alignment with economic and development strategies including an aspect of climate change and environment at the national and regional levels; Enhancing effective resource mobilization including through PPP.*

## Key Observations of Japanese Aid

**Drivers of Japanese Aid:** In its early years, Japan's foreign aid was driven primarily by its commercial interests. Japan wanted to ensure that both the donor and recipients benefited from aid – Japan would gain access to raw materials and markets for export; recipient

92 Kato, Hiroshi. "Japan's ODA 1954–2014: Changes and continuities in a central instrument in Japan's Foreign policy." In *Japan's Development Assistance*, pp. 1-18. Palgrave Macmillan, London, 2016.

93 Gao, Charlotte. "Amid US-China Tensions, Xi and Abe to Meet in Beijing." – *The Diplomat*. for *The Diplomat*, October 24, 2018. Accessed January 22, 2022. <https://thediplomat.com/2018/10/amid-us-china-tensions-xi-and-abe-to-meet-in-beijing/>.

94 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

95 Ibid.

96 Kato, Hiroshi. "Japan's ODA 1954–2014: Changes and continuities in a central instrument in Japan's Foreign policy." In *Japan's Development Assistance*, pp. 1-18. Palgrave Macmillan, London, 2016.



countries would achieve economic growth.<sup>97</sup> The commercial characteristic of Japan's aid infrastructure is made evident by how strongly its aid is tied. In 2010, 94 percent of Japanese aid was tied, against the DAC average of 16 percent. In 2018, Japan pledged to untie its aid and has reportedly reduced the share of its tied aid to 22.4 percent. But concurrently, the share of contracts won by Japanese firms from the untied aid has increased dramatically, from 12 percent in 2012 to 88 percent in 2017.

Beyond its commercial interests, two other factors have shaped Japanese aid. The first was the fact that while other major countries could use their military power to push their foreign policy objectives, Japan's constitution prohibited it from doing so. Therefore, aid became one of its major tools for exerting influence.<sup>98</sup> The second was US pressure on Japan to increase its aid, with Japan consequently becoming the largest donor in terms of aid volume. Today, with China now a major donor, Japan is offering its aid in trying to preserve its influence in Asia and position itself as an alternative for recipient countries.

**Aid with Japanese Characteristics:**<sup>99</sup> Although Japan is a major DAC donor, its approach to aid differs from that of its counterparts. Unlike other donors, Japan traditionally used a *request-based approach* to aid,<sup>100</sup> based on the principle that recipient countries should know their development priorities.<sup>101</sup> From the 1990s, however, Japan began developing country-specific strategies and increasingly engaged with the government of recipient countries to identify projects.<sup>102</sup>

Another distinct feature of Japanese aid is its strong emphasis on infrastructure. Japan believes that infrastructure is key to economic growth, which provides the necessary platform for countries to take off on their development path. Following much criticism, Japan tried to shift towards the more conventional development priorities of other DAC donors, such as gender equity, good governance, and poverty reduction, and to other sectors such as health and agriculture.<sup>103</sup> But given its limited expertise in these areas, Japan continued to focus on the "hardware" aspect of these agendas.<sup>104</sup>

Japan provides aid as both grants and loans. It offers very limited grants, that too only to the very poor countries.<sup>105</sup> Its preferred instrument of aid is loans, offered on very high concessional terms. Japan claims to uphold the principle of "self-help" to motivate recipient countries to perform well. Not surprisingly, Japan is the only DAC donor to have historically given more ODA through loans than grants.<sup>106</sup> In 2016, Japan, with USD 8.4 billion, topped

97 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

98 Ibid.

99 This section is largely based on Kato et al. *Japan's Development Assistance*.

100 Kato et al (2015) note that in the early days, Japanese firms would take lead in identifying the projects and would convince recipient governments to submit a formal request to the Japanese government.

101 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

102 Shimomura, Yasutami, John Page, and Hiroshi Kato, eds. *Japan's development assistance: Foreign aid and the post-2015 agenda*. Springer, 2016.

103 Lancaster, Carol. *Foreign aid: Diplomacy, development, domestic politics*. University of Chicago Press, 2008.

104 Ibid.

105 Shimomura, Yasutami, John Page, and Hiroshi Kato, eds. *Japan's development assistance: Foreign aid and the post-2015 agenda*. Springer, 2016.

106 Tew, Rob. "Accounting for ODA Loans: The Effect of the New Rules." Development Initiatives. Accessed January 22, 2022. <https://devinit.org/resources/oda-loans-accounting/>.

the list of DAC donors providing ODA loans bilaterally to developing countries; Germany, in the second place, was providing half this amount in loans, i.e., USD 4.5 billion.<sup>107</sup> On the other hand, among major loan-giving donors, Japan was second only to Korea<sup>108</sup> in terms of giving the most concessional loans.

## 3.4 China

### Chinese Aid at a Glance

Since China is not a member of the DAC, it does not report its official foreign assistance figures, thus making it difficult to accurately gauge the volume and nature of Chinese aid. According to the White Paper on development assistance recently made public by the Chinese government, from 2013 to 2018, it gave out USD 41.8 billion in foreign aid. Because China differs in how it reports its aid data, it is not possible to directly compare with other donors. However, purely in terms of scale, one might say China is the sixth-largest donor with an annual average of about USD 7 billion. Independent researchers, however, estimate that annual Chinese aid for 2018 and 2019 was about USD 5.9 billion.

Africa receives the highest percentage of Chinese aid, followed by Asia. Between 2013 and 2018, these two continents received 44.65 and 36.82 percent of total Chinese aid, respectively.<sup>109</sup> The top recipient countries of Chinese aid are Angola, Pakistan, Ecuador, Russia, Laos, Ethiopia, Kenya, Venezuela, and Zambia.

### A Brief History of Chinese Aid

China's aid initiatives began as early as the 1950s. It began by providing aid, albeit in limited volume, to other communist countries such as North Korea and Vietnam.<sup>110</sup> In 1956, it extended aid to non-communist countries such as Nepal, Egypt, and Cambodia. Back then China had a fairly outward-looking foreign policy, as seen in its active participation in the Bandung Conference and its increasing footprint in Africa.<sup>111</sup> Premier Zhou Enlai had even made public his "Eight Principles of Economic and Technical Aid"<sup>112</sup> during his trip to Ghana. Some of those principles continue to guide China's current aid. For example, Chinese aid is based on the principle of equality and mutual benefit; China respects the sovereignty of recipient countries and does not attach any conditions to its aid, and China gives aid not to make the recipient countries dependent on it but "to help them embark on the road of self-reliance and independent economic development."

<sup>107</sup> Ibid.

<sup>108</sup> Ibid.

<sup>109</sup> State Council. *Xin shidai de zhongguo guoji fazhan hezuo bai pi shu [White Paper on China's International Development Cooperation in the New Era]*. State Council Information Office of the People's Republic of China, 10 January. 2021.

<sup>110</sup> Fuchs, Andreas, and Marina Rudyak. "The motives of China's foreign aid." In *Handbook on the International Political Economy of China*. Edward Elgar Publishing, 2019.

<sup>111</sup> Starting in 1963, Zhou Enlai, in a matter of over a year, visited over a dozen African countries.

<sup>112</sup> Enlai, Zhou. "The Chinese Government's Eight Principles for Economic Aid and Technical Assistance to Other Countries. January 15, 1964." *History and Public Policy Program Digital Archive* <https://digitalarchive.wilsoncenter.org/document/121560.pdf> (1964).

Following the end of Mao's era in 1978, China, under the leadership of Deng Xiaoping, launched massive economic reforms. In the process, China turned inward and transformed from a donor into a recipient of aid.<sup>113</sup> Japan was one of China's biggest donors, having disbursed a cumulative total of over USD 30 billion in ODA loans and USD 650 million in grants to develop economic infrastructures such as airports, railways, ports, and hydropower plants and to modernize China's state-owned enterprises.<sup>114</sup> Other DAC donors who provided large ODA loans to China during this period were France, Germany, and the UK. Japan and a few other countries have discontinued their aid to China, but others continue to do so. As a result of the reform initiatives, China has achieved unprecedented economic growth and become the second-largest economy in the world, second only to the US.<sup>115</sup> Interestingly, because China is still categorized as a developing country, it is still eligible to receive aid under international rules.<sup>116</sup>

In 1999, China adopted the Going Global Strategy. The country had accumulated vast foreign reserves, and this policy encouraged private and state-owned enterprises to invest abroad in assets of strategic and long-term interest. In the early 2010s, China, now confident about its position on the world stage, launched its most ambitious foreign aid initiative. At an event held in Kazakhstan in 2013, Chinese President Xi Jinping announced the launch of the One Belt One Road initiative that tied together with a new Silk Road Economic Belt and a 21st Century Maritime Silk Road. The project has since been rebranded as the Belt and Road Initiative.

## Key Observations of Chinese Aid

**Institutional Architecture of China's Aid:** China's aid apparatus is often portrayed as monolithic. In reality, it is quite fragmented. There is competition among many institutions responsible for different facets of Chinese aid.<sup>117</sup> The apex body that oversees China's aid, as with most things in China, is the Central Committee of the Communist Party of China, which directs it through its Foreign Affairs Leading Group.<sup>118</sup> Next in the hierarchy is the State Council, China's chief administrative authority, which provides overall guidance to the sector and approves specific policies of the various ministries. In 2020, the Council updated its white paper on aid, titled, *China's International Development Cooperation in the New Era*, which outlined China's vision for the sector.

Under these political entities, there are a number of government agencies with specific roles and responsibilities related to foreign aid. The most influential is the Ministry of Commerce (MOFCOM), which is responsible for China's expanding commercial interests

113 Vieira, Victor Carneiro Corrêa. "From Third World Theory to Belt and Road Initiative: International Aid as a Chinese Foreign Policy Tool." *Contexto Internacional* 41, no. 3 (2019): 529-551.

114 JICA. "Japan International Cooperation Agency Outline of Cooperation In Nepal." Japan International Cooperation Agency. Japan International Cooperation Agency (JICA) Nepal. Accessed January 22, 2022. [https://www.jica.go.jp/nepal/english/office/others/c8h0vm00009vyd39-att/brochure\\_07.pdf](https://www.jica.go.jp/nepal/english/office/others/c8h0vm00009vyd39-att/brochure_07.pdf).

115 In terms of nominal GDP.

116 "News: The UK's Aid Engagement with China - New ICAI Information Note." ICAI, April 27, 2021. <https://icai.independent.gov.uk/new-icai-information-note-the-uks-aid-engagement-with-china/>.

117 Lynch, Leah, Sharon Andersen, and Tianyu Zhu. 2020. *China's Foreign Aid: A Primer for Recipient Countries, Donors, and Aid Providers*. July. <https://bit.ly/37eHihD>.

118 This group comprises of 11 ministers from the foreign affairs, propaganda, international liaison, commerce, defense and state security.

across the globe. MOFCOM functions through various departments, but the primary task of managing aid belongs to the Department of Foreign Affairs (DFA). DFA has about 70 staff placed in divisions that focus on specific regions. It is responsible for drafting plans and policies and for approving and managing aid programs. The Ministry of Foreign Affairs (MFA) also has a significant role in overseeing China's aid. MFA's primary task is to build a strong political relationship with other countries and to ensure that China's aid is aligned with its foreign policy goals. However, MFA is traditionally considered to be less influential than MOFCOM.<sup>119</sup> But many are in favor of increasing MFA's role because MOFCOM has received criticism for prioritizing economic gains over China's strategic and diplomatic interests.<sup>120</sup> The Ministry of Finance (MOF) also shares some responsibility over aid in that it coordinates with MOFCOM for the budget and oversees China's contribution to multilateral institutions. But complicating matters, other government, and provincial agencies are also involved in matters of foreign aid.<sup>121</sup>

China's two policy banks, i.e., China Export-Import Bank (C-EXIM) and China Development Bank (CDB), feature prominently in China's overseas development financing. Established in 1994, C-EXIM is a fully government-owned entity with MoF as its only shareholder. It is the primary agency in China for providing concessional loans, but it also provides export credits. However, despite MOF's responsibility over C-EXIM, in reality, C-EXIM works closely with MOFCOM, especially in areas of its financing that are considered to be aid. CDB, on the other hand, is focused on domestic lending and provides commercial lending only. In 2016, for example, CDB's lending in foreign currency accounted for 30 percent of the country's entire banking sector, which indicates its important role in China's overseas finance.<sup>122</sup>

In 2018, China established the Chinese International Development Cooperation Agency (CIDCA). This was partly in response to the growing criticism that China's fragmented aid sector hindered institutional coordination and that the lack of accountability mechanisms resulted in poor project implementation. CIDCA was also expected to help resolve the tension between MOFCOM and MFA over the control of China's growing aid portfolio.<sup>123</sup> It has been entrusted with a number of tasks that could increase its influence in the future, such as coordinating Chinese aid, representing China in aid negotiations with recipient countries, and signing international aid agreements.<sup>124</sup> It is expected to help streamline and align the focus of China's overall aid system. This contrast is evident in the fact that CIDCA is housed under MOFCOM but reports directly to the State Council and is expected to provide strategic recommendations to China's top leadership. However, critics say CIDCA has been given limited authority to carry out these tasks. Moreover, the authority to implement aid remains with other government agencies.

119 Varrall, Merriden. "Domestic actors and agendas in Chinese aid policy." *The Pacific Review* 29, no. 1 (2016): 21-44.

120 Zhang, Denghua, and Graeme Smith. "China's foreign aid system: structure, agencies, and identities." *Third World Quarterly* 38, no. 10 (2017): 2330-2346.

121 Rudyak, Marina. "The Ins and Outs of China's International Development Agency." *Carnegie-Tsinghua: Center for Global Policy. Beijing* (2019).

122 Chen, Muyang. "Beyond donation: China's policy banks and the reshaping of development finance." *Studies in Comparative International Development* 55, no. 4 (2020): 436-459.

123 Rudyak, Marina. "The Ins and Outs of China's International Development Agency." *Carnegie-Tsinghua: Center for Global Policy. Beijing* (2019).

124 Ibid.

**Drivers of Chinese aid:** China’s motivation for providing foreign aid can be divided into three categories: political; commercial; and development and humanitarian.<sup>125</sup> On the political front, the primary driver for China’s foreign aid is linked to its “One China Policy.” This position goes back to the establishment of the People’s Republic of China, which was a response to the decision of major western countries to recognize the Taipei-based Republic of China as the legitimate representative of China to the UN.<sup>126</sup> China invested heavily in trying to reverse this decision, increasing its foreign aid to developing countries as a way to win their support. It did finally succeed in its endeavor in 1971. The “One China Policy” has been a top priority for China, and countries that recognize Taiwan do not receive any Chinese aid.<sup>127</sup> China also relies on its aid to get the recipient countries’ support to bolster its position vis-à-vis western countries in international arenas.<sup>128</sup>

China’s aid is equally influenced by its commercial interests, as evidenced by the MOFCOM’s large influence over the aid sector. In this regard, China’s aid programs, especially those of a more commercial nature, seek to open international markets for Chinese firms and facilitate trade and investment. This is especially true of aid programs aimed at meeting the goals of the Chinese government’s Going Global Strategy and the need to find the necessary markets for its domestic firms to expand into. China is also keen to secure access to natural resources outside of the country. Some scholars point out that Chinese aid has been used for this purpose, especially in Africa.<sup>129</sup> In this regard, many of China’s strategies are reminiscent of the early days of Japanese aid, where Japan sought to open up commercial opportunities and secure access to raw materials for its domestic production.

Finally, China’s aid is driven by the interest to assist the development initiatives of recipient countries. Additionally, China also provides humanitarian aid, generally as part of emergency response during humanitarian crises around the world.

**Financing Mechanism:** The three instruments that China uses to provide aid are grants, interest-free loans, and concessional loans. These accounted for 47.3 percent, 4.2 percent, and 48.5 percent, respectively, of the USD 41.8 billion allocated for aid from 2013 to 2018, as reported by the Chinese government.<sup>130</sup> China can employ a mix of these instruments plus commercial financing for any one project, in that some portion of a project can be funded through a grant and others through concessional loans and even commercial loans.

China provides grants to its lowest-income recipient countries, mainly to invest in social welfare projects such as schools and hospitals. They have also provided grants to several countries for large and symbolic infrastructure projects such as parliamentary buildings and sports complexes. China also provides grants in response to humanitarian crises.

125 For a full detailed analysis of the motives of China’s Foreign Aid, see Fuchs, Andreas, and Marina Rudyak. “The motives of China’s foreign aid.” In *Handbook on the International Political Economy of China*. Edward Elgar Publishing, 2019.

126 Fuchs, Andreas, and Marina Rudyak. “The motives of China’s foreign aid.” In *Handbook on the International Political Economy of China*. Edward Elgar Publishing, 2019.

127 Ibid.

128 Ibid.

129 Wolf Jr., C., Wang, X, and Warner, E. 2013. China’s Foreign Aid and Government-Sponsored Investment Activities: Scale, Content, Destinations, and Implications. RAND National Defense Research Institute.

130 State Council. *Xin shidai de zhongguo guoji fazhan hezuo bai pi shu [White Paper on China’s International Development Cooperation in the New Era]*. State Council Information Office of the People’s Republic of China, 10 January. 2021.

China's zero-interest loans, which constitute the smallest portion of its aid, are also directed to its lowest-income recipient countries. These loans range from as little as USD 2 million to as large as USD 80 million, with a maturity period of 20 years and a grace period of 5 years. However, these loans are becoming rare as China pushes for concessional and preferential lending. It is important to note that this is the only type of loan that China writes off.

China's government concessional loan (GCL) typically does not meet the OECD definition. Its interest rate is slightly higher than that of loans from DAC members. According to some estimates, this rate is below the market rate but often fixed at 2-3 percent. These loans are provided through the Exim bank and are tied; recipients have to use at least 50 percent to purchase Chinese goods and services. The amount ranges from USD 100 to 750 million and mostly funds small and medium infrastructure projects. China also extends preferential buyers credit (PBC), which is subsidized export credit for purchasing Chinese products and services. PBC is similar to GCL in terms of interest rate, maturity, and grace period, and both are extended through the Exim Bank.

### Key Characteristics of China's Aid and Aid-Like Loans<sup>131</sup>

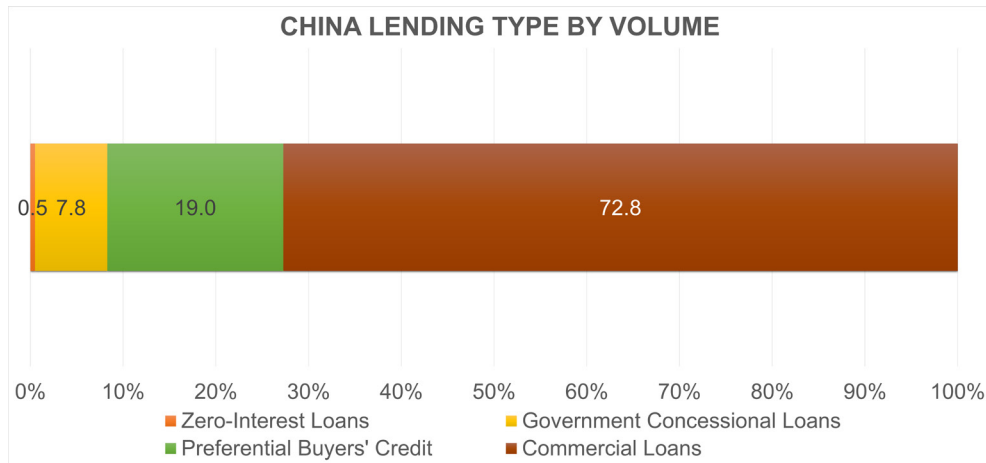
	Zero-Interest Loan	Government Concessional Loans	Preferential Buyers Credit
<b>Agency in charge</b>	MOFCOM	C-EXIM	
<b>Amount (in USD)</b>	2-80 million	Typically 100-750	
<b>Interest Rate</b>	0%	Usually fixed at 2-3%	
<b>Loan Period</b>	20-year maturity period; 10-year grace period	15-20-year maturity period; 5-year grace period	
<b>Currency Denomination</b>	RMB	RMB	USD
<b>Key Characteristics</b>	The only type of loan that China is willing to write off	Considered aid. Mostly for infrastructure; at least 50% tied to Chinese goods and services	Considered aid-like. 100% tied to Chinese goods and services

Beyond the aforementioned aid instruments, commercial or near-commercial loans account for about three-fourths of China's overseas lending. Despite their commercial nature, these loans are treated as part of China's development finance because the entire lending process – from negotiations to disbursement – takes place through a government-to-government channel.<sup>132</sup>

131 GroupeAFD. "Financing Development: A Chinese Path?" YouTube. YouTube, October 2, 2020. <https://www.youtube.com/watch?v=NKPbHoAa6Zc>.

132 Ibid.

## China's Lending Volume, By Type



China has been providing commodity-backed loans, which critics see as China's strategy of capturing natural resources. China frequently provides low-interest loans to countries that rely on commodities, such as oil or mineral resources, as collateral. In such cases, the recipient countries usually have low credit ratings and have great difficulty obtaining funding from the international financial market. China provides them funding with certain conditions.<sup>133</sup>

## 3.5 India

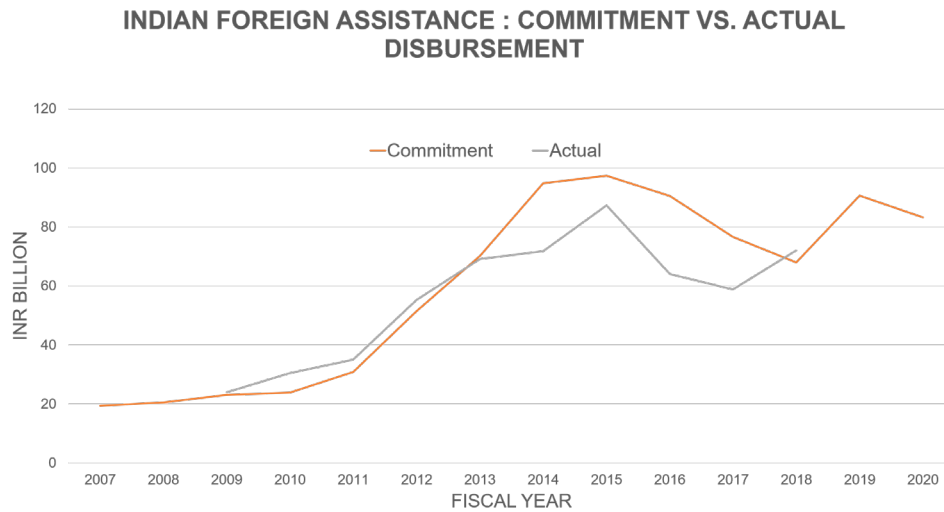
### Indian Aid at a Glance

India does not report its foreign aid figures to the DAC, which makes it difficult to ascertain the actual quantity of its aid, especially in relation to other traditional donors. But according to the Government of India's Union Budget for 2019-2020, India's foreign assistance commitments for that year stood at USD 1.32 billion, slightly less than the 2015-2016 budget that had committed USD 1.52 billion. This is, however, a significant increase from early 2000, when Indian assistance amounted to well under USD 500 million. However, despite the increase in absolute terms, the 2019-2020 commitment constitutes only about 0.33 percent of the overall budget.<sup>134</sup>

<sup>133</sup> Sun, Yun. "China's aid to Africa: monster or messiah." *Brookings East Asia Commentary* 75 (2014).

<sup>134</sup> Mullen, Rani D., "Indian Development Cooperation Regains Momentum: 7 main take-aways from India's 2019-20 Union Budget," Centre for Policy Research, July 2019, pp. 2.

## Indian Foreign Assistance: Commitments Versus Actual (INR billion)



Source: Compiled from the Government of India Union Budget Reports

### A Brief History of Indian Aid

India is often portrayed as an “emerging donor”, a term that is not very well appreciated in India, given that India has been providing aid since its independence in 1947. Jawaharlal Nehru, India’s first prime minister and the architect of Indian foreign policy,<sup>135</sup> stated that despite its limited resources, India had a responsibility to help other countries, especially those that were also emerging from their colonial past.<sup>136</sup>

India’s first bilateral aid was to Bhutan in 1949, a few years after the Indian independence.<sup>137</sup> India also provided aid through the Colombo Plan, an initiative founded in 1951 by a group of Commonwealth nations<sup>138</sup> to support developing countries in Asia through the transfer of capital and technology, and investments in the development of human capacity.<sup>139</sup> While Bhutan continued to be a major recipient of Indian aid, India has also provided support to its other neighbors, i.e., Bangladesh, Nepal, Maldives, and Sri Lanka.

During the 1990s India’s reshaped its view of itself and its approach to foreign aid. Until then, India had chosen a socialist planning approach that resulted in a mismanaged economy and entrenched poverty.<sup>140</sup> During this period, i.e., between 1951 and 1992, India was the world’s

135 Jain, Dinesh Kumar. “India’s Foreign Policy.” Ministry of External Affairs, Government of India, February 25, 2014. <https://mea.gov.in/indian-foreign-policy.htm>.

136 Nigam, Shailly. “India’s Foreign Aid: Social Responsibility or Hegemonic Strategy.” *International Journal of Technical Research and Applications* (2015): 17-25.

137 Mullen, Rani, Hemant Shivakumar, Kailash Prasad, Sanjana Haribhakti, and Jain Sanskriti. “The State of Indian Development Cooperation. A Report.” *Centre for Policy Research, New Delhi* 28 (2014).

138 Australia, Britain, Canada, Sri Lanka, India, New Zealand, and Pakistan.

139 Colombo Plan Secretariat. 2012. “The Story of the Colombo Plan”

140 Rajagopalan, Shruti. “The 1991 Project: The Quest for Economic Freedom in India.” *The 1991 Project*. Mercatus Center at George Mason University. Accessed January 22, 2022. <https://www.the1991project.com>.



largest recipient of aid having received USD 55 billion from different countries.<sup>141</sup> But as India was hit by a spate of financial crises towards the late 1980s, the Indian government announced a number of liberal reforms that opened up India's erstwhile command economy to the market forces.<sup>142</sup> Through these reforms, India was able to lift a quarter of a billion of its citizens out of poverty and propel the Indian economy to become one of the largest and most vibrant in the world.<sup>143</sup>

With this economic accomplishment, India tried to shift its narrative from being an aid recipient to a donor. In its budget speech of 2003/2004, it announced that it would no longer accept bilateral aid from countries other than the US, the UK, Russia, Canada, Japan, and the European Union. It also committed to repaying its bilateral and multilateral debts and subsequently settled the USD 1.6 billion owed to over a dozen countries and USD 2.8 billion to the World Bank and the Asian Development Bank.<sup>144</sup> To further demonstrate its credibility as an emerging donor, India, under its newly established India Development Initiative, canceled the bilateral debt worth USD 24 million owed by seven African countries and increased its contribution to the United Nations from USD 2.4 million in 2002 to USD 3.7 million in 2004.<sup>145</sup> Since then India has consistently increased its assistance, becoming a net provider of foreign aid in 2012.<sup>146</sup>

## Key Observations of Indian Aid

**Institutional Architecture of Indian Aid:** The Ministry of External Affairs (MEA) is the key institution responsible for coordinating the many facets of Indian aid. Given the increase in the amount – in real terms and in aspiration, the MEA, in 2012, created the Development Partnership Administration (DPA) within the ministry to handle India's aid projects from “conception, launch, execution, and completion.”<sup>147</sup> The DPA has three divisions that are responsible for specific tasks and regions. DPA-1 handles the implementation of the Lines of Credit (LoCs) and grant projects related to Bangladesh; DPA-2 handles the implementation of training under the Indian Technical and Economic Cooperation, humanitarian assistance, and grant projects related to countries in Southeast Asia, Central Asia, West Asia, and Latin American; and DPA-3 handles the implementation of grant projects in Afghanistan, Maldives, Myanmar, Nepal, and Sri Lanka.<sup>148</sup>

The Ministry of Finance (MoF) manages all assistance that India provides to multilateral institutions<sup>149</sup> and oversees the LoCs.<sup>150</sup> But even here, the diplomatic mission under the

141 Bijoy, C. R. “India: Transiting to a global donor.” *AID Management Committee. South-South Cooperation: A Challenge to the Aid System* 6576 (2010).

142 Rajagopalan, Shruti. “The 1991 Project: The Quest for Economic Freedom in India.” The 1991 Project. Mercatus Center at George Mason University. Accessed January 22, 2022. <https://www.the1991project.com>.

143 Ibid.

144 Bijoy, C. R. “India: Transiting to a global donor.” *AID Management Committee. South-South Cooperation: A Challenge to the Aid System* 6576 (2010).

145 Ibid.

146 “Mea: E-Citizen/RTI : Parliament Q & A : Lok Sabha.” Ministry of External Affairs, Government of India. Accessed January 22, 2022. <https://bit.ly/3ItBYHc>.

147 Mullen, Rani, Hemant Shivakumar, Kailash Prasad, Sanjana Haribhakti, and Jain Sanskriti. “The State of Indian Development Cooperation. A Report.” *Centre for Policy Research, New Delhi* 28 (2014).

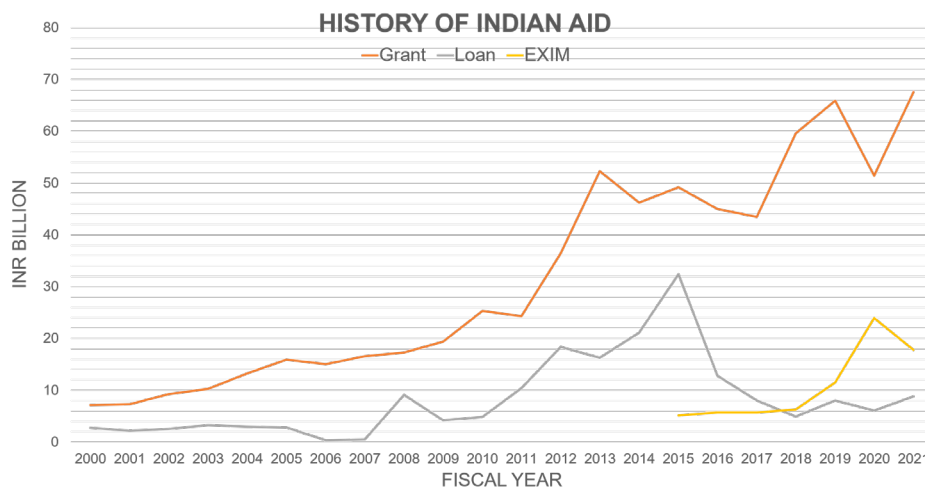
148 Nigam, Shailly. “India's Foreign Aid: Social Responsibility or Hegemonic Strategy.” *International Journal of Technical Research and Applications* (2015): 17-25.

149 In 2015, India channeled around six percent of its overall concessional development finance through multilateral organizations, of which most of it goes to International Development Association (35%) and to the UN (31%).

150 “India's Development Co-Operation.” OECD. Accessed January 22, 2022. <https://bit.ly/3qQLIW3>.

MEA is tasked with the initial liaising between the responsible agency in the borrower country and the Foreign Trade Division of the Department of Economic Affairs under the MoF in India. Other individual ministries, as per the relevance of the aid, are also involved in developing the respective budgets that support bilateral or multilateral assistance. All of the budget is finally channeled through the MoF.<sup>151</sup>

**India’s Aid Mechanism and Characteristics:** Grants make up a large share of Indian aid, most of which have been historically concentrated around its neighborhood. These grants are often provided through government-to-government mechanisms and used to fund large infrastructure projects in recipient countries. But India has other instruments such as the Small Development Project through which it can provide grant locally, with the emphasis on local implementation “to spread the impact of aid” and “to increase the outreach of Indian aid” in the recipient country<sup>152</sup>.



Indian aid also includes loans for specific projects. But these have been on a significant decline since 2015. Instead, India’s preferred mechanism since 2004 is the LoC,<sup>153</sup> which is extended to recipient countries through the Export-Import (Exim) Bank of India.<sup>154</sup> To date, India has extended over 300 LoCs worth USD 30.66 billion to 64 countries. Of this, USD 15.90 billion have been extended to Asian countries, with USD 7.86 to Bangladesh, USD 2.02 to Sri Lanka, and USD 1.65 billion to Nepal, among others.<sup>155</sup> India has also been increasing its LoCs to the African continent: Africa accounted for 32 percent of the total LoCs in 2004-2005, a figure that rose to 59 percent in 2012-13. The terms of these LoCs depend on how the recipient countries are classified, i.e., whether these countries fall under the *low and lower*

151 Nigam, Shailly. “India’s Foreign Aid: Social Responsibility or Hegemonic Strategy.” *International Journal of Techninal Research and Applications* (2015): 17-25.

152 Sridharan, *Emerging foreign assistance policies of India and China: India as a development partner*, 42.

153 LoC is not a new concept with India having offered, till 2003, 83 government-to-government LoCs to 23 countries of USD 498.56 million. These were charged to the budget and disbursed through the State Bank of India.

154 The government has an Interest Equalization Scheme through which it covers the difference between the interest rate at the market and at which the LoCs are offered.

155 “Lines of Credit for Development Projects.” Ministry of External Affairs, Government of India. Accessed January 22, 2022. <https://mea.gov.in/Lines-of-Credit-for-Development-Projects.htm>.

*middle income* or *developing* countries and whether the IMF has prescribed a *minimum binding concessional credit* or not. It should be noted that India reports a “grant element” in the LoC, which is not a separate offering, but rather an inbuilt component that is defined as the “net present value” of the loan and the actual amount of the loan.<sup>156</sup>

Country classification	L & LMI countries with a minimum binding concessional requirement	L & LMI countries with no minimum binding concessional requirement	Other developing countries
<b>Rate of interest</b>	1.50%	1.75%	Libor+1.5%
<b>Maturity</b>	25 years	20 years	15 years
<b>Moratorium</b>	5 years	5 years	5 years
<b>Grant element</b>	37.48%	31.37%	24.31%

India also offers capacity-building opportunities and technical assistance to recipient countries. For example, the MEA introduced the Indian Technical and Economic Cooperation (ITEC) program to provide training and other skill development opportunities.

India also provides humanitarian assistance as part of its foreign aid. For example, India provided USD 2.2 million and USD 1.1 million respectively to Sri Lanka and the Maldives in the aftermath of the Indian Ocean Tsunami of 2004. This was in addition to the assistance provided for transporting relief and medical supplies and running field hospitals.<sup>157</sup> During the 2015 earthquake in Nepal, India was among the first to respond with relief and rescue materials. Among other things, India committed USD 250 million in grant and USD 750 million in LoC for Nepal’s post-earthquake reconstruction.<sup>158</sup> Most of India’s humanitarian aid is provided to its immediate neighbors.<sup>159</sup>

The Indian government maintains that its aid follows the principles established by Prime Minister Nehru, who emphasized “non-interference, robustness ensured via shared experience, and partnerships which provide mutual welfare.”<sup>160</sup> Indian aid is, therefore, demand-driven, in that the government of the recipient country identifies the projects and India responds to their requests. Unlike western aid, Indian aid does not come with conditions.<sup>161</sup> One exception is the LoC, which generally requires that recipient countries procure 75 percent of the goods and services from India.<sup>162</sup> India also emphasizes that its aid is guided by the principles of South-South cooperation.

156 “Approved LOC Guideline 2015 - Ministry of External Affairs.” Accessed January 22, 2022. [https://www.mea.gov.in/Images/pdf/Approved\\_LoC\\_Guideline\\_2015.pdf](https://www.mea.gov.in/Images/pdf/Approved_LoC_Guideline_2015.pdf).

157 Nigam, Shailly. “India’s Foreign Aid: Social Responsibility or Hegemonic Strategy.” *International Journal of Technical Research and Applications* (2015): 17-25.

158 “India-Nepal Partnership in Post-Earthquake Reconstruction.” Embassy of India, Kathmandu, Nepal. Embassy of India, Kathmandu, Nepal. Accessed January 22, 2022. <https://bit.ly/3429961>.

159 Chakradeo, Saneet. “Neighbourhood First Responder: India’s Humanitarian Assistance and Disaster Relief.” Brookings. Brookings, August 18, 2020. <https://www.brookings.edu/research/neighbourhood-first-responder-indias-humanitarian-assistance-and-disaster-relief/>.

160 Nigam, Shailly. “India’s Foreign Aid: Social Responsibility or Hegemonic Strategy.” *International Journal of Technical Research and Applications* (2015): 17-25.

161 “Overview of India’s Development Partnership.” Ministry of External Affairs, Government of India. Accessed January 22, 2022. <https://www.mea.gov.in/Overview-of-India-Development-Partnership.htm>.

162 A relaxation of 10% may be considered on a case-to-case basis for projects involving significant civil construction work.

**Drivers of Indian Aid and Regional Engagements:** Aid is an important foreign policy tool for India. This is made evident by the MEA's central role in India's aid architecture and the fact that most of the Indian aid goes to countries within its sphere of influence. Between 2000 and 2018, India allocated over 70 percent of its grants and loans to its immediate neighbors, namely, Afghanistan, Bhutan, Bangladesh, Maldives, Nepal, and Sri Lanka. Beyond the political interest, India uses aid to secure resources and to open markets for India's exports.<sup>163</sup> Within South Asia, India is investing in energy projects, especially in hydropower-rich countries like Bhutan and Nepal, and, in more recent times, in connectivity projects in the region.

Amid China's growing engagement in South Asia, India feels the pressure to increase its aid commitment to South Asia. Some of its large investments in the region are said to be in direct response to Chinese aid. These include an LoC of about USD 966 million to Sri Lanka for a railway project and a USD 400 million LoC plus USD 100 million grant to the Maldives for the Greater Malé Connectivity Project<sup>164</sup> that aims to connect the four islands of Maldives.<sup>165</sup>

India's engagement in Southeast Asia shows that Indian aid is also driven by commercial interests. This region receives around 11.28 percent of India's total exports and is India's fourth-largest trading partner. India's Act East Policy guides this engagement. India also participates in forums organized by the Association of South-East Asian Nations (ASEAN)<sup>166</sup> on topics related to economic cooperation in trade and investment.

Among the Southeast Asian countries, Myanmar receives the largest Indian aid. Myanmar is strategically located between India's northeastern states and offers the only land route for India into the greater region. Aid to Myanmar has increased from a modest USD 6 million in 2008 to USD 50.5 million in 2018-2019, in addition to an LoC of USD 196.98 million it received in 2015.<sup>167</sup> Laos and Vietnam have also received Indian aid in the form of LoCs worth USD 600 million and USD 72.4 million, respectively. Given the centrality of the Indo-Pacific region in the current global power politics, India seeks to develop closer ties with each of the countries in the region.

Another region where India has gradually expanded its presence is Africa. Not only is India looking to portray itself as a global power by providing aid to African countries, but India also seeks to gain "diplomatic influence, oil reserves, and market for Indian goods" in the region.<sup>168</sup> In 2008, India hosted the first India-Africa Forum Summit, an effort to bring Indian and African political leaders together on one platform, which resulted in an Africa-India Framework for Cooperation.<sup>169</sup> The two sides have met three times as part of this Summit, resulting in a combined Indian commitment of USD 2 billion in grant and USD 10 billion in

163 Mishra, Abhishek. "The Changing Nature of India's Lines of Credit to Africa." ORF, May 25, 2018. <https://www.orfonline.org/expert-speak/changing-nature-india-lines-of-credit-africa/>.

164 Javaid, Arfa. "Greater Male Connectivity Project (GMCP): All You Need to Know." Jagranjosh.com, August 21, 2020. <https://www.jagranjosh.com/general-knowledge/greater-male-connectivity-project-1598019460-1>.

165 Miglani, Sanjeev. "India Announces \$500 Million for Maldives Project to Counter China Influence." Reuters. Thomson Reuters, August 13, 2020. <https://www.reuters.com/article/us-india-maldives-idUSKCN2591XW>.

166 ASEAN is an intergovernmental organization of ten Southeast Asian countries, viz., Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

167 Choudhury, Angshuman, and Ashutosh Nagda. "How India Funds the World: Financial Assistance in the Immediate Neighbourhood." *Economic and Political Weekly*. Economic and Political Weekly, June 4, 2019. <https://www.epw.in/engage/article/how-india-funds-world-financial-assistance>.

168 Tieri, *India, a new foreign aid donor? The case of Indian aid to Sri Lanka*, 36.

169 Wagner, Christian. *India's Africa Policy*. Stiftung Wissenschaft und Politik, 2019.

LoCs.<sup>170</sup> Currently, over 89 projects in 41 countries in Africa are being implemented with Indian LoC. Many of these are infrastructure projects, such as power projects and dams in Sudan and Rwanda; water treatment in Tanzania; sugar factories in Ethiopia; and technology parks in Mozambique and Eswatini, among many others.

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170 Mishra, Abhishek. "The Changing Nature of India's Lines of Credit to Africa." ORF, May 25, 2018. <https://www.orfonline.org/expert-speak/changing-nature-india-lines-of-credit-africa/>.

## 4. OVERARCHING OBSERVATIONS

### 4.1 Criticisms of Western Aid

Western aid has received a fair amount of criticism since its beginning. This report presents the broad ideas underlying such criticism rather than examining the criticism itself. Those interested in delving into the various kinds of criticism can look up the sources referred to in this section.

One of the oldest criticisms of western aid is based on dependency theory. Proponents of this theory<sup>171</sup> reject the assumptions of aid and modernization theory – that all countries are at various stages of progress and the poorer countries can be propelled onto the path to modernity with financial and technical assistance from the richer countries. Instead, they emphasize that, given the unique characteristics of each country, this linear trajectory of development is both impossible and questionable.<sup>172</sup> In this view, the unequal relationship between the rich and poor countries will widen existing inequalities, with aid making the latter more dependent on the former.<sup>173</sup> However, scholars argue that empirical evidence from the growth experiences of many less developed countries does not support such claims.<sup>174</sup>

The most widespread criticism of western aid has to do with its alleged ineffectiveness in delivering the promised development. This issue was first raised as early as the 1970s as the stated development outcomes of aid – of poorer countries being lifted out of poverty – did not adequately materialize. It was said this was a result of aid being designed purely as technical assistance. As a remedy, non-technical aspects such as governance were included in aid packages. However, despite having contributed trillions of dollars in aid since then, proponents of aid do not have much to show for in terms of outcome. Critics reject the assumption that aid can alleviate systemic poverty and maintain that aid has in fact resulted in more poverty in developing countries, not less.<sup>176</sup> This, they argue, is because aid props up unaccountable governments, undermines internal political forces that can bring reforms, and enables opportunistic actors to engage in corruption.<sup>177</sup> Further, critics note that aid

171 As Kabonga, 2016 notes, dependency theory is not a single theory but rather a consolidation of ideas of many theorists,

172 Kabonga, Itai. “Dependency theory and donor aid: a critical analysis.” *Africanus* 46, no. 2 (2016): 29-39.

173 Ibid.

174 Sánchez, Omar. “The rise and fall of the dependency movement: does it inform underdevelopment today?.” *EIAL: Estudios Interdisciplinarios de America Latina y el Caribe* 14, no. 2 (2003): 31-50.

175 Kabonga, Itai. “Dependency theory and donor aid: a critical analysis.” *Africanus* 46, no. 2 (2016): 29-39.

176 Moyo, Dambisa. *Dead aid: Why aid is not working and how there is a better way for Africa*. Macmillan, 2009.

177 Krasner, Stephen D. “Foreign aid: Competing paradigms.” *Journal of Intervention and Statebuilding* 5, no. 2 (2011): 123-149.

is ineffective because of the manner in which donors implement their aid programs. They highlight the fragmentation of aid and the lack of coordination among donors.

Another criticism is that countries that receive western aid have little agency in the negotiation and implementation of aid projects, and therefore lack ownership of such projects. In theory, those in international development circles recognize that recipient countries must have ownership over aid in order for it to be effective. Between 2003 and 2014, the OECD organized the High Level Forum on Aid Effectiveness in cities such as Rome, Paris, Accra, Busan, and Mexico City.<sup>178</sup> At these forums it was agreed that developing countries would “set their own strategies for poverty reduction, improve their institutions and tackle corruption,” while donor countries would “align behind these objectives and use local systems.”<sup>179</sup> However, in reality, western aid programs are rarely initiated at the request of recipient countries but reflect the funding priorities of donor governments. Furthermore, these programs are often designed<sup>180</sup> and implemented by consultants and contractors from the donor country. There are various factors that promote this arrangement including the fiduciary and political risks associated with program funds, the aversion of donor bureaucrats to take on these risks,<sup>181</sup> as well the limited absorptive capacity of recipient governments.

Finally, western donors are criticized for their programmatic interventions, especially the conditions attached to their aid. Some think these conditions allow donors to interfere in the “sovereign prerogatives of recipient governments.”<sup>182</sup> While many of these conditions are sector-specific technical reforms, others are political in nature and can be unpalatable to the government of the recipient country.<sup>183</sup> Some also argue that western aid is based on western values and ideals, which are then imposed on non-western recipient countries.<sup>184</sup> Further, western aid is often criticized for the contradictions between its diplomatic and developmental goals. Western countries use aid to bolster their national security while also promoting human rights, equity, and democracy.<sup>185</sup> However, when these two objectives are not aligned, western countries are accused of sacrificing the latter to achieve the former.

## 4.2 Criticisms of Chinese Aid

China is often portrayed as a country that provides aid solely to fulfill its parochial national interest, i.e., to increase its global power,<sup>186</sup> at the detriment of the recipient countries. The most common criticism of Chinese aid, at least in the mainstream media and some academic

178 These fora have been held in Rome (2003), Paris (2005), Accra (2008), Busan (2011) and Mexico City (2014).

179 OECD, DAC. “Paris declaration on aid effectiveness.” <https://bit.ly/3GXJRV5> (2005).

180 William D. Savedoff, 2019. “What Is “Country Ownership””? A Formal Exploration of the Aid Relationship.” CGD Working Paper 519. Washington, DC: Center for Global Development. <https://www.cgdev.org/publication/what-country-ownership-formalexploration-aid-relationship>

181 Ahmad, T. S., and A. Wainer. “The Power of Ownership: Transforming US Foreign Assistance.” (2016).

182 Zormelo, Douglas. *Is Aid Conditionality Consistent with National Sovereignty?*. Overseas Development Institute, 1996.

183 Schmitz, David F. *The United States and right-wing dictatorships, 1965-1989*. Cambridge University Press, 2006.

184 Paige, Shannon. “Time to Decolonise Aid.” Time to decolonise aid. Insights and lessons from a global consultation. Peace Direct. Accessed January 22, 2022. <https://www.peacedirect.org/wp-content/uploads/2021/05/PD-Decolonising-Aid-Report.pdf>.

185 Williams, David. “The history of international development aid.” In *Handbook of Global Economic Governance*, pp. 233-248. Routledge, 2013.

186 Varrall, Merriden. “Domestic actors and agendas in Chinese aid policy.” *The Pacific Review* 29, no. 1 (2016): 21-44.

and policy circles in the west, is that China uses aid to engage in predatory lending, i.e., as a strategy of entrapping poorer countries in massive debt in order to acquire strategic assets. This so-called “debt-trap diplomacy,” a term first coined in 2017, gained currency as it was picked up by western academia<sup>187</sup> and popular media. The idea soon found space in policy circles from Washington D.C. to New Delhi, with even some of the highest level officials across the globe referring to this phenomenon. The case most often cited as an example of China’s “debt-trap diplomacy” is the Hambantota Port in Sri Lanka. Many prominent scholars of China aid, however, have shown that none of the allegations about China’s predatory lending practices are substantiated.<sup>188</sup> This is not to dismiss concern over exposure to external debt or the need to closely examine the practices of development finance.

Another major criticism comes from a security angle and has to do with China’s dual-use strategy whereby China invests in civilian projects that can be transformed for military purposes. There is a strong security narrative around the development of the BRI and a growing call for America to respond to the Chinese threat. This undercuts China’s narrative that the BRI provides mutual benefits to China and the recipient countries and that the BRI’s only goal is economic development. As one source points out, the “seemingly overbuilt but underutilized ports along important Indian Ocean trade routes [...] appear more suitable as potential naval bases than as commercial operations.”<sup>189</sup> It is said that China is investing in many commercially sub-optimal projects with the ulterior motive of converting these civilian/commercial enterprises into military ones if and when needed. Some even go as far as calling these projects “Trojan horses” that China can leverage to “advance strategic and defense priorities.”<sup>190</sup>

Among the host of criticisms of Chinese aid, the most common is that China has established very low social and environmental standards for infrastructure projects that it finances. China’s policy has been to delegate this responsibility to the governments of recipient countries, but critics allege that oftentimes the recipient governments have very low standards and China turns a blind eye. China is also criticized for the low labor standards in its investments; that it brings in its own labor; and there is a lack of the transfer of technology to recipient countries. Further, Chinese aid is accused of looking to capture the natural resources of recipient countries and to buy out elites through open corruption.

### 4.3 Countering China

The US is eager to counter China’s rise. In the recently declassified document on the *U.S. Strategic Framework for the Indo-Pacific*, the US states that China’s growing economic, diplomatic and military influence can result in the loss of American preeminence in the Indo-Pacific region and limit its ability to achieve its interests.<sup>191</sup> Through the Indo-Pacific Strategy (IPS), the US is intent on making its partner countries in the Indo-Pacific “resistant

187 Rithmire, Meg, and Yihao Li. “Chinese Infrastructure Investments in Sri Lanka: A Pearl or a Teardrop on the Belt and Road?” *Harvard Business School Case* (2019): 719-046.

188 Rudyak, Marina. “The Ins and Outs of China’s International Development Agency.” *Carnegie-Tsinghua: Center for Global Policy. Beijing* (2019).

189 Russel and Berger, *Weaponizing the belt and road initiative*, 5.

190 Ibid.

191 “U.S. Strategic Framework for the Indo-Pacific.” USNI News, January 15, 2021. <https://news.usni.org/2021/01/15/u-s-strategic-framework-for-the-indo-pacific>.



to Chinese activities aimed at undermining their sovereignty, including through covert and coercive influence.” Among other things, in the IPS, the US states that it will communicate “the strings attached to China’s ‘Belt and Road Initiative’ and to develop a robust public diplomacy capability, which can compete with China’s information campaigns; puncture the narrative that Chinese regional domination is inevitable.”<sup>192</sup> Furthermore, the US seeks to counter the Chinese influence in the region by supporting India’s aspiration to become a global power.<sup>193</sup>

Along with the IPS, the US is also re-emphasizing its alliance with India, Japan, and Australia under the Quadrilateral Security Dialog framework, popularly known as the Quad. The Quad was originally established in response to the Boxing Day Tsunami of 2004 but was soon promoted as an “informal grouping” of the four participating nations to tackle regional issues. By 2007 the Quad had gained some political traction, having formally met in Manila and soon after conducted a joint military exercise.<sup>194</sup> But China reacted quite strongly against this build-up, and in 2007 the member countries decided not to take this initiative further. In the meantime, two things were happening: first, the Quad members continued their bilateral engagements to develop stronger ties, and, second, China’s relationship with each of the four Quad countries soured, and even turned confrontational. As a result, the Quad was formally revived in 2017, and this time with a clearer emphasis on the need to contain China. However, the Quad is yet to provide a clear strategy for their coalition. A key question this raises is: Will the current coalition evolve into a security alliance like the North Atlantic Treaty Organization (NATO)?

To counter China’s infrastructure-oriented BRI initiative, the US and Japan have launched initiatives that are also heavily focused on infrastructure development. On the American side, the BUILD Act gives the primary responsibility of challenging China on this front through the DFC. In its first year of operation, i.e., FY 2020, the DFC reported having committed USD 1 billion in the energy sector across eight countries and USD 447 million in technology and infrastructure. At a more project-specific level, DFC reported having invested in projects such as the Owendo Port in Gabon, a 420 MW electricity power plant and a 25-kilometer connection in Mozambique, a 105 MW solar power plant in India, and a 46 MW solar farm in Malawi, among others. These DFC investments are relatively small, especially when compared to those being made by China’s policy banks. But the agency is still in its early phase and it remains to be seen how it will evolve. Another US agency with a significant focus on infrastructure is the MCC.

Japan has always had a strong preference for investing in infrastructure, as its aid portfolio amply demonstrates. Since the 1950s, Japan has been providing aid to meet the infrastructure demands of recipient countries in Asia. However, its powerful position in the region has gradually waned amid China’s rise. To counter this, Japan has been emphasizing on quality through its *Partnership for Quality Infrastructure* initiative, in an apparent effort to distinguish itself from China’s cheaper and less sophisticated offerings.<sup>195</sup> The stated principles of the initiative reflect its strength – *reliable operation and economic efficiency in*

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192 Ibid.

193 Ibid.

194 Buchan, Patrick Gerard, and Benjamin Rimland. *Defining the Diamond*. Washington DC: Center for Strategic and International Studies, 2020.

195 Pascha, Werner. “Belts, Roads, and Regions: The Dynamics of Chinese and Japanese Infrastructure Connectivity Initiatives and Europe’s Responses.” Asian Development Bank. Asian Development Bank Institute, April 2020. <https://www.adb.org/sites/default/files/publication/579761/adbi-wp1114.pdf>.

*view of the lifecycle cost, ensuring job creation, capacity building, and transfer of expertise and know-how to local communities, addressing social and environmental impacts.* Chinese aid in infrastructure is criticized precisely for lacking these elements. However, China competing with Japan can have a positive influence as China will need to win over the confidence of its recipient partners.<sup>196</sup>

The western allies, however, do not have a coherent response to China. For example, the US discouraged its allies from joining both the AIIB and the BRI, but many have chosen to do otherwise. Even close allies such as the UK, Australia, India, and South Korea have become members of the AIIB. Furthermore, Europe is divided on how to engage with China on the BRI. In 2019, Italy became the first major European nation to sign the MoU with China for the BRI. It is challenging for western countries to present a common approach to China because each country has bilateral commercial ties with China. China is set to become the largest economy in the world and these countries cannot let go of the potential economic opportunities it brings. The UK has shown interest in engaging with China on the BRI. It seeks to be an “honest broker” and improve the BRI as a global public good, which includes creating healthy competition for the BRI and developing the capacity of the recipient countries to engage with China on the BRI. Even Japan has shown some interest to engage with China; in 2018 the two countries announced their plan to collaborate to build a high-speed rail project in Thailand.<sup>197</sup>

## 4.4 Aid, Development, and the Chinese Narrative

Despite being one of the biggest beneficiaries of the post-WWII globalized world order, China claims that the current arrangements, with all its international laws and institutions, seek to “protect the interests of the colonial and imperialist powers to the detriment of the most undeveloped nations and peoples.”<sup>198</sup> To work through this, China relies on a pragmatic strategy of exploiting the system to draw whatever possible benefits it can while trying to redefine the existing order according to its own terms. When it comes to foreign aid, China feels that the aid framework is dominated and dictated by the west and is keen to replace it with its own narrative.

First and foremost, China prefers to define aid as an opportunity to create a win-win situation and one that can ensure mutual benefits for both parties. This is in sharp contrast to the western notion of aid that puts emphasis on the charitable nature of aid.<sup>199</sup> In a 2017 speech at the UN in Geneva, President Xi Jinping made this clear: “Instead of begging thy neighbor, countries should stick together like passengers in the same boat.”<sup>200</sup>

196 Harris, Tobias. “Quality Infrastructure: Japan’s Robust Challenge to China’s Belt and Road.” *War on the Rocks* 9 (2019).

197 Shimada, Gaku. “Japan and China Take First Step toward Joint Infrastructure Abroad.” *Nikkei Asia*. Nikkei Asia, September 4, 2018. <https://asia.nikkei.com/Politics/International-relations/Japan-and-China-take-first-step-toward-joint-infrastructure-abroad>.

198 Williams, Robert D. *International Law with Chinese Characteristics: Beijing and the “rules-based” Global Order*. Brookings Institution, 2020.

199 Scholar like Fukuyama point this as being grounded on the Christian values.

200 “Work Together to Build a Community of Shared Future for Mankind.” *Xinhua*, January 19, 2017. [http://www.xinhuanet.com/english/2017-01/19/c\\_135994707.htm](http://www.xinhuanet.com/english/2017-01/19/c_135994707.htm).

China's narrative about aid goes back to the principles established by Zhou Enlai back in the 1960s and is echoed in the most recent White Paper that it made public in 2020. In these documents, China emphasizes respect for sovereignty, frequently mentioning that it does not interfere in the internal affairs of recipient countries. This is essentially in response to the condition-laden development aid provided by western countries. These principles lend specific characteristics to Chinese aid. For example, China prefers to work directly through national governments; it does not really engage with non-state actors. It does not provide policy-based loans or budget support. China also prefers to finance projects in *turnkey*<sup>201</sup> arrangements. Also, because Chinese aid is often tied, Chinese funds do not even make it to the recipient country. Chinese banks directly pay Chinese contractors.

China emphasizes that it is, despite all its recent development, still a developing country<sup>202</sup> and that its bilateral financial assistance is within the framework of South-South Cooperation (SSC), which is aimed at helping and supporting other developing countries. At the 2009 meeting of the Ministers of Foreign Affairs of the G77 countries and China, the SSC framework was defined as “a common endeavor of peoples and countries of the South... pursued as an expression of South-South solidarity and a strategy for economic independence and self-reliance of the South.”<sup>203</sup> One of its core principles is that financial contributions from one country to another should not be seen as ODA but “as expressions of solidarity and cooperation borne out of shared experiences and sympathies.”<sup>204</sup> To show its commitment to this framework, in 2015 China established the South-South Cooperation Assistance Fund with an initial contribution of USD 2 billion, with an increase of another USD 1 billion in 2017.

## 4.5 Aid, Infrastructure Development, and Multilateral Institutions

In addition to bilateral assistance, many DAC donors channel their aid through multilateral institutions. These include the United Nations, the World Bank, and the regional banks such as the Asian Development Bank and the African Development Bank. In 2011, 70 percent of ODA was conducted bilaterally and 30 percent through multilaterals.<sup>205</sup> In contributing through these multilateral institutions, donors can also allocate part of the funds for specific areas of their interest. For example, in 2018 the US provided USD 10.2 billion through multilateral organizations, of which 38 percent was allocated as core contributions and the rest earmarked for specific countries, regions, themes, or purposes.<sup>206</sup> The World Bank received the highest share, i.e., 28 percent, followed by UN agencies at 24 percent, and 40 percent was allocated to other multilaterals.<sup>207</sup> A major function of these multilateral

201 Turnkey in construction refers to projects being handed by the contractor in a state that is complete and ready for operation.

202 State Council. *Xin shidai de zhongguo guoji fazhan hezuo bai pi shu [White Paper on China's International Development Cooperation in the New Era]*. State Council Information Office of the People's Republic of China, 10 January. 2021.

203 “Ministerial Declaration.” The Group of 77. Accessed January 22, 2022. <https://bit.ly/3rDKGAU>.

204 Ibid.

205 OECD. *What is Aid?*. 2011

206 “DAC Member Profile: United States.” OECD. Accessed January 22, 2022. <https://www.oecd.org/dac/unitedstates.htm>.

207 The Global Fund (GF) is an international financing organization, designed to accelerate the end of AIDS, tuberculosis and malaria epidemics by providing support to countries in the response to the three diseases.

institutions, especially the World Bank and other regional banks, has been to finance infrastructure projects of developing countries.

Donors work with multilateral institutions for a number of reasons such as economies of scale and specialization. One such reason is the professed political neutrality of these institutions, as their mandates prohibit them from interfering in the internal politics of recipient countries. This provides a greater degree of legitimacy while working with recipient governments, who may be more receptive to programmatic interventions and policy concessions if they do not have to worry about their sovereignty being undermined or having to acquiesce to the demands of other governments.<sup>208</sup>

This is not to say that these institutions are completely apolitical. For example, the decision-making arrangements of many of these institutions reflect their shareholding structure, which heavily favors the more affluent western countries and their allies. These countries, therefore, have considerable influence over the institutional direction of the multilateral organizations and the overall agenda for development. The UN is one multilateral institution that differs in this regard, with its one-member-one-vote system, which gives relatively more weight to countries with fewer resources. But even here, some states wield more influence than others due to their membership in the Security Council or as one of the five countries with the Right to Veto. Moreover, the bureaucracy of these institutions often favors the major shareholders.<sup>209</sup>

China is aware of the benefits it reaps by engaging with, and through, these institutions. And although China's influence over these institutions does not match its political and economic position, it is not interested to dismantle the existing arrangement. What it wants instead is to increase its influence over these institutions. To that end, it is portraying itself as the leader of the developing nations and giving voice to their demand for more representation in these institutions. Concurrently, China has increased its contributions to these institutions. In 2010 China was able to increase its votes from 2.77 percent to 4.42 percent in the World Bank. In 2019 Chinese officials led four out of the fifteen specialized agencies of the UN.<sup>210</sup>

	WB	AIIB	NDB	ADB
<b>Established</b>	1944	2015	2015	1966
<b>Headquarters</b>	Washington, D.C., US	Beijing, China	Shanghai, China	Manila, Philippines
<b>No. of Member Countries</b>	190	Members: 72 Prospective: 26	5+2	Asia and Pacific region: 49 Others: 19
<b>Largest shareholders: percent vote</b>	US: 15.8% Japan: 7.7% China: 4.7%	China: 26.1% India: 7.5% Russia: 5.9%	Each member holds 20%	Japan: 15.6% US: 15.6% China: 6.4%
<b>Paid in Capital</b>	USD 18 billion	USD 10 billion	USD 10 billion	USD 7.5 billion

208 ODI Report. Bilateral versus Multilateral Channels: Strategic choices for donors.

209 Anwar, Dewi Fortuna. "Leadership in the history of Southeast Asian integration: the role of Indonesia in ASEAN." In *Regional Integration in East Asia and Europe*, pp. 77-86. Routledge, 2006.

210 "Trace China's Rise to Power." Council on Foreign Relations. Council on Foreign Relations. Accessed January 22, 2022. <https://www.cfr.org/china-global-governance/>.

Despite some success in increasing its influence over the existing multilateral institutions, China is aware that western countries and their allies have far greater control over these institutions. In China's view, this control is a throwback to a bygone era and does not reflect current realities.<sup>211</sup> Also, the US has hindered China's efforts to increase IMF's resources and thus gain more voting shares.<sup>212</sup> Therefore, China's other strategy is to establish new multilateral institutions that it has more control over. The first such institution was the New Development Bank (NDB), which was a joint initiative of the five major emerging countries of Brazil, Russia, India, China, and South Africa. Headquartered in Shanghai, China, the NDB was established in 2014 with an initial authorized capital of USD 100 billion. It reports that by December 2019 it had invested over USD 15.2 billion in 53 projects.<sup>213</sup> The NDB has plans to increase membership, with Bangladesh and the United Arab Emirates being admitted in late 2021.

The other multilateral institution that China established was the Asian Infrastructure Investment Bank (AIIB). At its inception in 2015, the AIIB had 57 founding members and an initial authorized capital of USD 100 billion. The AIIB was given the primary mandate of investing in infrastructure and connectivity. By 2019 it had 72 members and 26 prospective members; key western allies such as the UK and Australia had also taken up membership against the wishes of the US. Not surprisingly, at 26.1 percent, China owns the highest percentage of voting shares among all members. Overall, the AIIB had invested USD 12.04 billion in 63 projects.<sup>214</sup>

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211 Feng, Huiyun, and Kai He. "China's institutional challenges to the international order." *Strategic Studies Quarterly* 11, no. 4 (2017): 23-49.

212 Dollar, David. "The AIIB and the 'One Belt, One Road'." Brookings. Brookings, September 7, 2017. <https://www.brookings.edu/opinions/the-aiib-and-the-one-belt-one-road/>.

213 "Annual Report 2019: Investing for Innovation." New Development Bank, February 10, 2021. <https://www.ndb.int/annual-report-2019/>.

214 "Home - 2019 AIIB Annual Report and Financials." Home - 2019 AIIB Annual Report and Financials. Asian Infrastructure Investment Bank (AIIB). Accessed January 22, 2022. <https://www.aiib.org/en/news-events/annual-report/2019/home/index.html>.

## 5. CONCLUDING THOUGHTS

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China's use of aid to project its influence, with its own set of "Chinese Characteristics," is changing the parameters of discussion in foreign aid. The West is critical of China's failure to adequately consider the social and environmental costs of the infrastructure projects it finances. However, there is also an awareness that many recipient countries are keen to receive aid from China, due to China's willingness to meet their financial needs to invest in infrastructure. While Western donors had decreased their priority in this sector, it is now concerned that China might undercut their influence in developing countries across the globe. This has compelled them to rethink aid for infrastructure, beginning a new era of the politics of infrastructure diplomacy.

As should be evident from this report, there is increasing discourse around the world to better understand these new dynamics. Analysts are busy grappling with the emerging complexities brought on by the rise of China and the West is trying to respond to the new competition. In all this, however, what is often overlooked is the recognition of corresponding complexities in the positions and outlook of recipient countries. All too often, recipient countries are portrayed as passive and lacking both capacity and agency. Such a view overlooks the fact that recipient countries have gained significant state capacity over recent decades and their political institutions have, for the most part, evolved in the direction of greater democratic accountability. There are even complex internal debates on aid and diplomacy that are taking place within these countries. But whether these discourses are adequately informed for them to be able to devise a coherent and strategic response is doubtful.

We end this primer with a parting thought on the relevance of this discourse, on aid, infrastructure, and diplomacy, for Nepal. Clearly, Nepal's policy of non-alignment, which it has maintained since the Cold War, has been useful in projecting its neutral position, while being able to leverage aid from a diverse set of countries, including the US, India, China, the UK, Japan, and even the USSR. However, the new world order that is currently taking shape, as we have noted repeatedly in this report, is more complex than ever before: for example, instead of uni- or bi-polarity, there is multipolarity; instead of rigid and well-defined blocs, there are multiple and shifting alliances; and the development of a technology-based globalized economy, as well as the common threats such as climate change, makes cooperation essential even among rivals. Successfully navigating these phenomena will require a rethinking of past approaches and the adoption of newer and supple strategies. But if we examine the recent discourses over aid and diplomacy in Nepal, it is quite evident that there is a lot of work to be done. This must begin with more fact-finding research that helps frame the key policy challenges at hand, which should be fed into a public discourse that includes a wide-ranging set of stakeholders. The final product of this exercise should be a more coherent national strategy that is able to capture our position in the new world order and provide guidance on how best to avoid the risks while exploiting the new opportunities that are available.

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