The Anatomy of China’s Influence on the International Development Finance System

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解析中国对于国际发展援助体系的影响

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Abstract

The entry of China as an emerging economic power into the development financing scene has raised the question of its impact on international aid architecture. The paper argues that this question cannot be fully understood unless we realize that the origin and on-going evolution of the current rules in international aid regime represent a process of political contestation both on the international level and on the domestic level. They are the outcome of conscious aid policy coordination among DAC donors to avoid crass competition and promote burden sharing. However, undue coordination dominated by hegemonic ideas of what is best aid practice may stifle alternative notions of what development is and how official flows can promote the development. After uncovering the political dynamics of existing rules and standards, the author collected first-hand data through in-depth interview in Beijing to discover that China has no incentives to participate in the current DAC dominated aid policy coordination due to domestic and international political considerations. Furthermore, China has taken a pragmatic approach to international standards and rules on development assistance. On the one hand, China is willing to draw lessons from the international practices to reform its domestic aid governance structure. On the other hand, China has deliberately distinguished itself from the DAC approach by criticizing the appropriateness of the current standards and rules and highlighting its distinctive “South-South Cooperation” approach. In addition, the author took a step further to uncover how domestic bureaucratic politics creates ambiguous attitude towards international rules due to the vested bureaucratic interests. It concludes that China has enhanced the momentum of creating a space for alternative development ideas and policy options, although such impact is not an outcome of China’s conscious efforts but an unintentional impact due to the competition China brings to DAC donors and the alternatives it provides to recipient countries.

摘要

作为新兴援助国中国进入国际发展援助领域，学者开始研究中国对于国际援助体系的影响。这篇文章认为只有深刻理解了国际和国内的政治过程如何产生并推进了国际援助体系的发展，才能更好地理解中国对于当前国际发展体系的影响。国际援助体系是发展援助委员会的援助国为了避免恶性竞争、达成成本分担而进行的援助政策协调的结果。然而，关于“最佳”的援助理念和做法的霸权会导致过分的协作，遏制了发展理念和实践的多样性。作者首先分析了当前规则和标准背后的政治逻辑，然后通过深度访谈发现中国基于国际和国内政治的考虑并没有意图加入当前发展援助委员会主导的援助政策协调体系。而且，中国对发展援助的国际标准和规则采取了务实的态度。一方面，中国希望从国际上汲取经验来改革国内的援助体系。另一方面，中国有意识的通过“南南合作”将自己同国际发展援助委员会的方式区分开来。最后，文章总结到中国为多样性的发展理念和政策选择提供了发展的空间，尽管这个结果并非中国特意努力的结果，而是它自身的做法无意间给发展援助委员会的援助国带来了竞争和挑战。
I. Introduction

China’s recent engagement with Africa has sparked a heated debate about its impact upon the international aid architecture. On one hand, some argue that China has undermined norms and rules built by the DAC donors and that it should and will be socialized into the current international aid regime (Stähle, 2008). On the other hand, others maintain that China as a major emerging donor has the potential of establishing a viable alternative to the existing aid regime and brings “a silent revolution” to the current aid system (Woods, 2008).

Despite their diverging standpoints, the above two arguments have two points in common. First, they take a dichotomised view of traditional donors and emerging donors. Second, they mainly explore the impact of China on the international aid architecture from the outsider’s perspective. However, such an approach is limited for two reasons: (a) it fails to identify the diversity within each group as well as the commonality between the two groups; (b) it assumes that China has the motivation to undermine the current international aid architecture and fails to uncover China’s attitude towards the specific rules and standards within international aid architecture.

The present paper aims to put the contemporary debate into a comparative historical and political economy perspective, for the influence of China upon international aid architecture cannot be fully understood unless we have a better understanding of the underlying political forces that have shaped the existing rules and norms as well as the political considerations in the mind of Chinese aid officials.

The paper addresses this challenging question of the influence of China on the international aid regime in two ways. The first half of the paper argues that the origin and on-going evolution of the current rules in the international aid regime is a process of political contestation both on the international level and on the domestic level. These rules are also the outcome of conscious aid policy coordination among DAC donors to avoid crass competition and promote burden sharing. However, undue coordination dominated by hegemonic ideas of what is best aid practice may stifle alternative notions of what development is and how official flows can promote development. The second half of the paper discusses China’s pragmatic attitude towards the existing rules and standards that govern development assistance. It concludes how the entry of China as an emerging economic power into the
global development finance scene has created a space for alternative development ideas and policy options. It is important to note that such impact is not a conscious effort on the part of China but an unintentional impact due to the competition it brings to DAC donors and the alternatives it provides to recipient countries.

II. The Political Economy of the Origin and Evolution of Rules and Norms in International Aid Regime

In this section, I will examine two pillars of the current international aid regime: one is the standard definition of official development assistance (ODA), and the other is the untied aid principle. The conventional technical approach to the two rules has downplayed their political implications. But in fact they indirectly shape the idea of what is aid and what is good aid policy; these prevalent ideas may crowd out other alternative approaches.

**ODA: Is Concessionality Enough?**

Official development assistance is a man-made technical item. Among all kinds of official financial flows, only those that meet the following criteria can be counted as ODA:

- (a) undertaken by the official sector;
- (b) with promotion of economic development and welfare as the main objective; and
- (c) at concessional financial terms (if a loan, having a grant element of at least 25 per cent calculated at a fixed 10% of discount rate).

Although it is a technical category, it has been “ideologically and politically loaded so that it is commonly considered to be, in fact, a North-South flow, more or less linked to the 0.7% of GDP commitment” (Bracho 2010).

If we look back to the history of ODA, it is an international obligation made by the rich countries to the global south and a construct to measure burden-sharing efforts among DAC donors.

The 25% level was introduced in 1972 in the DAC Recommendation on the Terms and Conditions of ODA. It was intended to set a minimum level of grant element, and thus limit the scope of transactions that could be reported as ODA. The 25% was not considered the main issue; more emphasis was placed at the time on the overall grant element of each
donor’s total ODA programme (the norm for total aid was set at 84 per cent in 1972 and raised to 86 per cent in 1976). The higher the grant element imposed for counting a given transaction as ODA, the less scope there would then be for the donor to offer loans while still meeting the overall grant element targets that the DAC was specifying in these recommendations. The point of it all was to promote equality of burden sharing among DAC members, the terms of whose development assistance varied, several of them giving no loans at all. In those years all DAC members were implicitly considered to have roughly equal capacities to provide aid.

But nowadays the definition of ODA has been under question. In particular, in the current low interest rate environment, concessionality in the sense of loans available at below market interest rates, is not measured. The fixed 10 per cent discount rate may produce a grant element of more than 25 per cent even for loans that are above market interest rates. When this discount rate was adopted in the 1972 Recommendation, it was a standard number that was close to the figure used in DAC member countries to assess the viability of proposed domestic investments. It was thus a reasonable benchmark for assessing the opportunity cost to donors of making funds available for aid instead of investing them domestically. The recent long periods of extremely low long-term bond rates, and the downward adjustment in some countries of benchmark expected rates of return on public investments, have tended to call into question the 10% discount rate. Although the fixed discount rate may be out of date, it is hard to reach agreement among DAC donors to change it. And it is hard to reach agreement on introducing a rule on what “concessionality” means in a low interest rate environment.

This technical definition has two interacting connotation. The first is that whether an official flow is aid or not depends on the claimed policy purpose rather than the actual outcome of aid projects. The second is that aid should as concessional as possible, as measured by the grant element. Consequently, it has created a widely accepted belief that aid should be delinked from trade and investment1, because the latter serve donors narrow national interests. Therefore, the best practice aid modalities should crowd out commercial

1 Although there is ‘aid-for-trade’ initiative in the DAC, this is viewed in a ‘non-national interest way’. Aid should be used to build up the capacity of recipient countries for trade rather than help build up direct trade and investment ties between donors and recipients.
elements to the greatest extent. And donors should give priority to grants rather than loans. As a result, social projects tend to be viewed more favourably than economic projects.

Such a view is based on a particular kind of aid philosophy—aid should be purely for altruistic purposes; aid that serves needs or interests of providers should be ‘shameful’. In other words, development purpose should be taken as priority rather than immediate national interests. Such a charity-based view of aid tends to establish the belief that “the more concessional, the better aid.” The development content of other capital flows falls outside such a frame.

One outcome of aid policy coordination in the past decades is to build up the altruistic foundation of aid discourse, and more recently, the enlightened self-interest aid discourse. Aid can contribute to global public goods, because aid can help achieve peace and security, etc. If the world is a more functional and peaceful place, it will benefit donors in the long run.

However, such a view divorces practice from political realities. In policy statements, donors assert that aid is primarily for development purposes; in policy practice, aid often serves as a tool for foreign policy. Motivations for giving aid are mixed, including humanitarian, enlightened self-interest, global public goods, and (strategic & short-term) national interests, the balance shifting over time.

This raises an interesting question: is it legitimate to pursue national interests when giving aid to poor countries? In the context of DAC Peer Reviews, this issue was raised explicitly in the DAC in 2006. In a letter addressing the issue the then chair of the DAC, Richard Manning, proposed that pursuing national interests and foreign policy objectives is fine as long as it also promotes development. This is a fairly recent acknowledgement that aid can also serve the national interests of a donor country. The current US Administration has made development co-operation an explicit arm of foreign policy, alongside defence and diplomacy.

China has used aid as an instrument of foreign policy and as a tool for economic cooperation, while its recent White Paper also evokes altruistic development objectives. Again this shows that there is no dichotomy between DAC and other aid providers. When countries are under certain level of development though, it is natural to pursue mutual interests and keep the contracts. When the countries get richer, they have a more global
vision in mind and care about ‘the state of the planet’.

In contrast to charity-based view of aid, aid can also be regarded as investment—good for donors and good for recipients. Aid philosophy is thus not clear-cut. While national interests are more to the fore in some countries than others, it is a fallacy to take national interests and development purpose as two exclusively dichotomised categories. Sometimes, they are a positive-sum game (genuine mutual benefits), while at other times, they are a zero-sum game. Moreover, member states may change their view of what counts as ‘national interests’ as the view of their domestic constituencies change or a new government comes into office. For example, sometimes, national interests are compatible with development purposes. Canada used to defend food aid because there was a strong farm lobby for it; later, the Canadian Wheat Board saw that they could gain more by winning a larger share of a liberalised global food aid market. In short, there is a nuanced relationship between national interests and development purpose. The mainstream altruistic view of aid has tended to separate aid from other commercially-related official flows. It also tends to put more emphasis on social sectors rather than economic sectors.

Untied Aid: Best Practices or Religious Belief?

Untied aid principle was for decades an unattainable “best practice norm” among DAC donors. At length, in May 2001, the DAC at its High Level Meeting reached agreement on a Recommendation to untie ODA to the least developed countries. The central objective is to untie ODA to the least developed countries “to the greatest extent possible” (OECD, 2001a: 3). Meanwhile, the Recommendation sets out strong transparency, implementation and review procedures to monitor compliance with the Recommendation (OECD, 2001b: 5). Members’ actions to implement the recommendation are continually monitored and their performance is measured against agreed statistical indicators. For instance, official development assistance contract opportunities are posted on a dedicated bulletin board.

Moreover, their tying policies and practices are also reviewed through the DAC Peer Review process and recorded in annual implementation reports to the DAC High Level Meeting.

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2 OECD website, “Untying aid: Official development assistance contract opportunities,” http://www.oecd.org/document/53/0,3746,en_2649_33721_45499637_1_1_1_1,00.html
The rationale of the Recommendation is based on the benefits of untied aid, including economic efficiency, country ownership, and procurement. This Recommendation is explicitly rooted in market principles. Apart from the merits of economic efficiency, another argument for untied aid is that it can build public procurement system for recipient countries. If all donors are tying their aid and aid is a big part of the total public investment budget, then the recipient country is having to learn to use multiple procurement systems. This will incur heavy transactions costs and it is not getting to build up its own competencies in running its own public procurement, a key part of a capable state.

On the surface, untied aid principle has been established for the development purpose. Yet, the process of reaching this agreement has been greatly shaped by international and domestic political economy. Here, we unpack this “black box” by tracing the negotiation process. The early multilateral efforts to untie aid were not initiated in the DAC. Instead, the disciplines were primarily negotiated in the OECD under the auspices of the Participants to the OECD Arrangement on Officially Supported Export Credits in 1992. This raises a puzzle—why did Export Credit Group rather than DAC lead the efforts to untie aid? If we look back to the negotiation process of The Arrangement on Officially Supported Export Credits (1978-2011), we would find that untied aid is a natural extension of OECD countries’ endeavour to “neutralize official export credit as a competitive element in capital goods exports.” (Moravcsik, 1989: 190) The rationale behind it is that if exporting countries give financial support freely and without constraints and do not obey the level playing field ‘international competitiveness rule’, it would lead to a worse-off situation for everyone. The negotiation process was a political process. Despite the early efforts to level the playing ground for export credits, DAC members used tied-aid credit to promote exports. The U.S. Treasury Department pressed for further reform to prevent other members from using tied aid as subsidized credits. This initiative was strongly opposed by European countries, especially the French government, for at that time, EU countries used export credits to amply help their own companies to win export markets. The US government, under pressure from its domestic industry groups, threatened to raise a “war chest” for “offensive” credits aimed at nations impeding negotiations on tied aid. From the perspective of the export credit disciplines, tied aid is another form of competitive finance, leading potentially to ‘economic
war’ among creditors to win contracts from developing countries (recipient countries). Finally, France yielded and a new compromise was reached (Moravcsik, 1989: 189-190). The above historical evidence can tell us how international politics played an important role in promoting the untied aid principle.

Apart from the negotiation on the international level, the domestic political economy also played a dispensable role. In 2000, before the UK put forward a proposal to reach a new agreement on untied aid principle, the head of the Department for International Development (DFID) consulted the Department of Trade and Industry for approval. The rationale of this proposal was that tied aid projects had become unsustainable in the UK, even though in the 1980s its commercially-driven aid projects had promoted trade and exports. The reason why tied aid became costly was that the products provided by a high-income donor country might not meet the needs of poor recipient countries. There was an illustrative case in point. In the 1980s, the money came out of Britain's aid budget and was given to India on condition it bought the helicopters. But Indian government had domestic requirements to lease these helicopters to its domestic companies. Due to their prohibitive price and the meagre demand, the UK had to offer extra subsidies to the Indian companies. As a result, these helicopters were like “Cathedrals in the desert” and costly for both the donor and the recipient. In addition, in the year 2000, the UK aid budget only made up 0.3% of UK’s GNI, and half was delivered through multilateral aid organizations. Thus, few domestic British companies relied on aid to make profits. Rather, most UK companies were internationally competitive and could win contracts from foreign countries if other donors untied their aid.

In short, DFID had good reason to press for untied aid principles. However, this proposal was strongly opposed by the French government. In France, the government, industry, and Parliament had formed a coalition to defend tied aid, since many French companies depended on aid projects in African countries, French former colonies, for profits. In addition, the national philosophy in France differed from UK. As a champion of free market principle, UK opposed government intervention in industry whereas France defended the legitimacy of the role of government in industrial policy.3 Apart from the bilateral negotiation, domestic

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3 The shift in aid policy from tied aid to untied aid was not a straightforward process. It was in fact a struggle between Ministry of Trade and aid agencies. The case of UK’s Pergau river project in Malaysia was scandal of a “bad” aid project
bureaucratic politics mattered. There was controversy within French government—French Treasury was in favour of reaching agreement since the budget costs were high and the subsidised insurance guarantees amounted to unfunded contingent liabilities, while Trade Department opposed untied aid agreement since its goal was to promote export. The French were reluctant also because their untying performance was not good but they gave a high percentage of their aid to least developed countries (i.e., their former colonies) and they wanted recognition for that. So the DAC invented a "reference index" to be published in the annual untying report. That helped France come on board the agreement. After intensive negotiations, the DAC donors reached agreement on a Recommendation to untie ODA to the least developed countries in 2001.

Furthermore, it is important to note that the Recommendation is not applied to food aid and technical assistance and that it does not include aid to middle-income countries. Food aid is a ‘forbidden subject’ in the DAC because the United States opposed to untie its food aid due to political opposition in the Congress, although the US administration and USAID fully understand the costs of tied food aid from the perspective of economic efficiency. Japan meanwhile, opposed the untying of technical co-operation, inter alia on the grounds that their consultants could not compete linguistically. These two exclusions, with their have political implications for key DAC donors, were necessary to reach the agreement. Therefore, the process of reaching an untied aid agreement is a political process. Even though this prevalent norm can be justified for the purpose of development, it took DAC members forty years to reach a collective decision to untie only a proportion of their bilateral aid (Manning, 2006: 378). It reminds us that norms must be grounded in the historical and institutional context.

In addition, whether DAC donors actually untie their aid is an empirical question. “The statistical trend towards untying remains encouraging. In 2008, 81% of all bilateral ODA was reported as untied, 15% as tied and the tying status of 4% was not reported. However, much improved performance on meeting the transparency provisions of the Recommendation (ex...
ante notifications of untied aid offers and reporting on contract awards) is needed to verify this position and confirm that aid that is de jure untied is also untied in practice.” (OECD, 2011: 3) The absence of legal or regulatory barriers does not necessarily guarantee that aid project is subject to genuine international competitive bidding. For example, in Japan’s aid projects the prime contractors are Japanese companies and EU aid projects can only be competed among EU countries. Again, domestic politics steps into aid practice. Public and business support for the aid effort might be undermined if aid projects funded by taxpayers are always won by foreign companies. Yet, in reality, the diverse interests among domestic constituencies are a mixed picture where some aid constituencies may vocally support untied aid efforts. The output of aid policy in donor countries cannot be truly understood unless we take the domestic decision-making into consideration.

However, the so-called “best practice norm” of untied aid has been questioned by some DAC donors. On 14-15 April 2010, at the Senior High Level Meeting during the discussion of Implementing the 2001 DAC Recommendation on Untying Aid: 2010 Review, Japan expressed its disappointment with the quality of the study and Germany also suggested that further evidence is needed on the costs and benefits of further untying (OECD, 2010: 9). In addition, disagreement also arose with regard to the scope of the untied aid Recommendation. Although the Secretariat considered that the Accra Agenda for Action (AAA) commitment applies to all aid, Japan and the United States opposed that interpretation --“Japan considers that the AAA commitment could apply to all aid but does not necessarily require all member countries to untie aid beyond the Recommendation and requires member countries to develop individual plans for further untying of aid based on their individual situations” and “the United States considers that the AAA commitment only addresses aid covered by the Recommendation.” (OECD, 2010: 6-7) Despite the disagreement on the actual effect of the untied aid Recommendation, the report of the discussion concluded that “the DAC will specifically address the recommendations to exploit the opportunities offered by untying to increase aid effectiveness and development impacts.” (OECD, 2010: 9)

While the majority of delegates were very happy with this report, some felt dissatisfied. Further interviews revealed why: the report merely focused on ‘how much’ aid is untied but touched little on the developmental impact of untied aid projects; and, untied aid as a result
has become the dissemination of ‘religion’, with aid officials defending the untied aid principle like ‘missionaries’ even though some untied aid projects may not serve a development purpose.6

Although the DAC official document acknowledges that one cannot say that all tied aid is ‘bad’ and that all untied aid is ‘good,’ (OECD, 2001b: 3) why does the DAC Recommendation prescribe to untie aid “to the greatest extent”? Why has the untied aid principle gained the dominant influence against tying aid? In the case of food aid, it seems clear that untying yields major benefits (in the case of Canada, the same food aid budget now buys twice as much grain) But one possible answer might be the triumph of neo-liberalism ideology—the free market principle and “right to choose” in an effort to minimize the government intervention. For instance, the official documents of DAC reflect the triumph of untied aid over tying aid -- “in light of the arguments in favour of untied aid, many donors have been increasing over time the relative importance of untied aid in their programmes.” (OECD, 2001 b: 3) So where do these arguments come from? Are they valid? The most popular argument for untied aid is that “tied aid raises the cost of many goods and services by between 15 to 30%.” Everybody quotes it without bothering to ask the source of the data. The wide circulation lends credence to it as a self-evidence truth. But in fact, this data is a shakily based thing.

“A degree of caution is necessary when examining the assumptions and approaches employed as they may reduce the relevance of the findings and restrict their practical applicability. The use of these models becomes problematic when conventional assumptions do not hold. Perfect competition and information are often assumed; findings may differ depending on whether the transfer is tied to manufactured goods or primary commodities. Findings may also vary according to whether the goods are private or public, consumption or investment, tradable or non-tradable, on whether flows are considered to be temporary or permanent, on the extent to which different characteristics of the economies are taken into account, or on the existence of quantitative trade restrictions, and so forth. Finally, the methodological approach (comparative static versus a comparative dynamic model) used in the analysis may influence findings, undermining their relevance in practical analysis.” (Clay,
Geddes, Natali and Willem te Velde, 2008: 34)

Even though the economic efficiency of untied aid projects should be evaluated on a case-by-case basis, which depends on the types of goods, the comparative advantage of donor countries and the compatibility of donors’ offer and recipient’s needs, there is another compelling reason for untied aid. For in principle, untied aid helps recipients to build country procurement systems gain country ownership. But in practice untied aid does not necessarily lead to recipient procurement. One reason is political pressure. For example, some DAC donors like the United States resist the move toward public procurement system. There are domestic political pressures from the US Congress. The other reason relates to the concerns over corrupt recipient governments; distrust of the foreign procurement systems makes donors prefer their own procurement systems. Thus, the recent DAC review on untied aid speaks of an unachieved target on “how project financing can use country procurement systems.” (OECD, 2010: 9) Nevertheless, the underlying political rationale of untied aid principle retains its force. Because aid is openly stated for development purposes, tied aid is seen to serve the interests of lenders. Therefore, tied aid is regarded as a ‘shameful’ practice in the aid community at large.

The above critique of the rationale on which untied aid is based and its actual implementation should come with two important caveats. It is not that untied aid is a bad principle and should be abandoned. Rather, it has played an important role in redressing the problem of inefficient tied aid projects. It is not that all efforts to untie aid are motivated by political and commercial calculations. Rather, there are numerous examples of genuine endeavours from Development Co-operation Directorates, donor aid agencies, and civil society to fight against the unsustainable tied aid projects that incur prohibitive costs to both donors and recipients that breed corruption in donor aid agencies and undermine the policy autonomy of recipient countries. The point to be made is that there is another side of the coin--the coordination among DAC donors is a process of political negotiation and compromise. Without taking political economy of aid policies into consideration, we cannot understand why DAC countries adopted certain features, rules or norms at a particular time to coordinate their aid policies.

Another important point to make explicit is that the power of hegemonic ideas plays an
important role in shaping the policy and practice of donor DACs. Here the power is latent—“certain ideas or belief systems gain power as they become more widely disseminated to people and get treated as common knowledge” (Hyden, 2008: 264). As a result, international organizations may serve as “gatekeepers in deciding what is right and wrong, normal or deviant” (Hyden, 2008: 264). Such hegemonic systems of knowledge navigate the policy orientation by ruling out alternative options. Consequently, policy makers may turn a blind eye to the negative effects of the widely-accepted belief and fail to appreciate the virtue of alternative policy instruments.

The domination of untied aid principle as a hegemonic belief can be shown in the following illustrative example. DAC has set out clear target to extend untied aid principle to the greatest extent and to the widest scope. Some DAC donors, for instance the United Kingdom, have claimed to untie their aid 100 %. But the problem with such maximization of untied aid efforts is that some aid projects cannot be untied by nature. For instance, the aid related with scholarship and migration is inevitably supplied by donor countries. The unquestioned belief on untied aid principle makes donors find it hard to live up with its own commitment. No one would disagree that elimination of scholarship aid for the sake of preventing any deviating cases from watering down the pure principle is a sensible decision.

Another consequence of the untied aid principle is that reduction in untied aid projects leads to a reduction in infrastructure financing. This creates the ‘gap’ that China and other emerging economic powers fill. 7 Further, the untied aid principle has downplayed the focus on other official flows (OOF). In 2003, the DAC Working Group on Financial Aspects of Development Assistance was abolished during a wider restructuring of the DAC machinery. Its underlying rationale: ‘untied aid’ is now in progress in DAC, with annual reports on untied aid, based on the 2001 recommendation. There seemed at the time to be no need to focus on OOF. Consequently, there is a ‘missing instrument’ in the DAC to assess the developmental aspects of OOF as well as to coordinate among member states regarding OOF.

In short, the untied aid Recommendation originated from the coordination efforts to neutralize export credits but later on it gained a life of its own shaping the scope of what

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7 This offers an alternative explanation on the decrease in infrastructure financing. The conventional wisdom is that infrastructure was not functioning well without maintenance, therefore, the World Bank and DAC donors choose to change it to other aid modalities. It is based on development rationale and fails to take political incentives into consideration.
counts as legitimate aid policies.

The case of untied principle reflects a common problem of modern bureaucracy. It tends to set clear target by monitoring simplified indicators to achieve the goal. But the flip side of such practice is that it presupposes that those measurable indicators based on agreed principles, albeit not reasonable in all cases, can achieve the shared goal. Consequently, the exclusive focus on these quantifiable indicators may come at the sacrifice of exploring what actually works to bring real development outcome. In fact, the validity of any principle hinges on its boundary and operating conditions. Overstretched principles in the absence of enabling environment can make the literal translation of the principle into indicators counterproductive.

What’s worse, the hegemonic power of a single principle threatens to rule out alternative ideas and approaches. One neglected argument for tied aid is that public private partnership can help to transfer technical knowledge and management skills from donor to recipient countries. The benefits of such knowledge transfer cannot be measured in dollar terms and cannot be obtained through international bidding process, especially when the knowledge is uniquely developed in certain donor countries and fits the local needs of recipient countries. This argument raises a deeper question on what is development cooperation. From this perspective, development is not merely capital transfer but also, more importantly, a mutual learning process over time between a donor and a recipient. Another argument for tied aid is that aid can play a vanguard effect to attracting FDI. This argument has been testified in the East Asian donors like Japan and South Korea. A counterargument would be that not all untied aid can increase the flow of FDI and not all FDI flow is conductive to development outcomes. Another counterargument would be tied aid could serve as an excuse to seek narrow commercial interests rather than development outcomes in poor countries. A third counterargument would be such transfer of knowledge should be tailored to local context and

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8 The recommendation was amended in March 2006 to eliminate the thresholds and in July 2008 to expand the coverage to the heavily indebted poor countries (HIPC). Since January 2002, ODA to the least developed countries has been untied in the following areas: balance of payments and structural adjustment support; debt forgiveness; sector and multi-sector programmes assistance; investment project aid; import and commodity support; commercial services contracts and ODA to NGOs for procurement related activities. Most Members have now untied all categories of ODA covered by the Recommendation. In the few remaining cases, full implementation of the coverage provisions is awaiting the conclusion of co-ordination processes. Australia, Finland, France, Germany, Ireland, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland and the United Kingdom have untied ODA beyond the requirements of the recommendation (OECD website).
cannot happen in a straightforward way. These are all valid points. It is true that we should avoid the abused forms of tied aid practice, it is also important to recognize the far-reaching development impacts of certain types of tied aid practice.

To conclude, the untied aid principle has played an important role to redress the inefficient tied aid projects on the basis of economic efficiency. But economic efficiency should not be the only criteria for what counts as good aid projects. Some aid projects under the framework of public private partnership are a channel for special knowledge transfer that cannot be obtained from the international bidding process. Moreover, its value cannot be fully appreciated on the basis of economic efficiency that mainly focuses on value for money and excludes dynamic development Impacts and learning processes.

III. China’s Attitude towards DAC Standards and Rules

Will China Adhere to the Standard of ODA?

In order to promote the burden-sharing among DAC donors, the Development Assistance Committee has collected and published the aid statistics on the basis of commonly accepted definition of ODA. Although it is a technical term on the surface, it has political connotations—aid is North to South transfer. The Chinese government has no incentive to follow the standard definition of ODA for two reasons. First, it is reluctant to shoulder the externally defined international responsibility—i.e., aid should make up 0.7% of gross national income. In the recently published China’s white paper on aid policy, it highlights that “China provides foreign aid within the reach of its abilities in accordance with its national conditions.” (Information Office of the State Council, 2011: 5) Second, from the perspective of Chinese officials, the adherence to the DAC’s standard of ODA would run the risk of grouping itself with rich DAC donors. Such implication is unacceptable in the eyes of domestic constituency, because its citizens would question the government’s aid policy given the fact that many Chinese people in the poverty-stricken areas are suffering from poverty. Moreover, Beijing treats the label of “South-South Cooperation” as a distinctive feature of its aid policy. Adherence to the DAC’s standards would encounter the opposition from the African countries because they would lose the opportunity of utilizing an alternative
development financing if China joins the club-based aid community.9

Although China has no incentive to join the DAC and report aid statistics to the DAC, it has taken a pragmatic approach to the standard definition of ODA. On the one hand, it is open to the international cooperation by learning from DAC’s practice. In particular, as China’s aid has surged and will continue the momentum in the near future, its aid policy has been subject to the scrutiny of international society. In 2008, the Ministry of Commerce initiated to draft the China’s first white paper on aid policy. Staff from the Development Assistance Department, Chinese Academy of International Trade and Economic Cooperation, was sent to the DAC to learn from its statistics department on how to calculate ODA. This marks a shift of China’s attitude towards international aid community. In the past, China’s aid policy was isolated from the international standard. Currently, China has gradually formulated its aid policy by taking into account of international standards. On the other hand, China is critical of the “inappropriate elements” of the current definition of ODA. For example, it has been pointed out that the current fixed 10 percent discount rate renders aid no less concessional than commercial finance. In addition, it criticized the specific calculation method of ODA. The current calculation of ODA includes the “administrative costs,” which refer to costs of aid agencies. It has created an incentive for aid agencies to expand its staff and to increase its costs, which helps to reach the goal of 0.7% of GNI. Another inappropriate element of ODA calculation from the perspective of the Chinese government is that the debt relief is calculated as grants. The Chinese aid officials plan to release the white paper on foreign aid regularly in the future on the basis of its own aid standards with reference to the international standard of ODA.

When it comes to the domestic politics of China’s aid policy, the Department of Aid to Foreign Countries in the Ministry of Commerce claimed to increase the proportion of grants compared with loans. Although the concessional loans have surged in the past decade led by the Ex-Im Bank, the Ministry of Commerce has taken a very cautious attitude towards the loans in fear of default. As a result, the Ex-Im Bank will take accountability of the loans and is willing to increase the proportion of loans subsidized by the Ministry of Commerce. In addition, unlike the practice of DAC donors that includes multilateral aid into the whole aid

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9 Interview in Beijing, on July 4, 2011.
budget, China does not include multilateral aid in its aid budget, which has reflected in the recent white paper on China’s foreign aid. Such divergence from international convention is not out of China’s conscious challenge to the international aid architecture, but an outcome of bargaining between Ministry of Finance and Ministry of Commerce. Ministry of Finance is in charge of deciding multilateral contribution. Although the Ministry of Commerce has tried very hard to make “multilateral contribution” as an integral part of aid budget, it failed to achieve the goal due to the opposition from the Ministry of Finance.

*Will China Untie its Aid Projects?*

The untied aid principle aims to increase value for money by reducing the cost of buying goods and services though international bidding. It also aims to level the playing ground by avoiding using aid as export subsidies.

From the perspective of outside observers, China’s aid projects are tied. According to the Chinese aid official, the reason why China chooses to tie its aid project is to reduce the costs. For one thing, international bidding procedures are complex and time-consuming. For another thing, China’s construction companies are very efficient. Although there is lack of the procedure of international bidding, the Ministry of Commerce selects the most competitive domestic companies to undertake the aid projects.

Moreover, Ministry of Commerce points out that the DAC donors fail to untie their aid projects, although they have claimed to untie their aid projects in principle. Therefore, the criticism from the DAC donors have no solid ground given they themselves fail to live up to the rules formulated by themselves. The Chinese aid officials claim that they would untie the aid projects if African partners make request to untie aid projects. They further point out that the key issue is not whether aid projects is tied or not and that the key criterion is whether aid project is cost efficient and whether aid projects can help promote employment and technological transfer in African countries. The Ministry of Commerce has stipulated that the ratio of Chinese workers to African workers should be 1 to 8. China may untie its aid projects if its cost of employing Chinese companies is increasing. But it would proceed on the basis of experimentation. In addition, China aid officials justify its tied projects on the basis that they help to pave the way for private investment. Based on China’s own development experience,
aid alone cannot achieve development. Therefore, it believes that tied aid projects can enhance development if they serve as vanguard effects of creating conditions for private investment.

**IV. The Unintentional Influence of China on International Aid Regime**

China as an emerging economic power is becoming a more and more important stakeholder in the global development finance. DAC has changed its strategy from outreach to new partnership without any conditions.

In the past, the DAC adopted Outreach Strategy in 2005, “outreach constitutes an essential element of the work of the DAC ... Enhanced Engagement aims to bring partners closer to the OECD and what it stands for by engaging them closely in OECD processes while supporting their own reform processes through the adoption of OECD practices, policies, guidelines or instruments.” On April 6-7, 2011, the DAC Senior High Level Meeting approved a new statement on “Welcome New Partnerships in Development Co-operation.” It shifted its attitude to emerging donors. It first tries to dispel the political implications of ODA and to seek the common ground with emerging donors by saying “ODA is not defined as a North-South transfer, but rather its criteria relate to the development purpose, concessionality, and the official nature of such flows of resources.” It then tries to persuade the emerging donors to make dialogue with DAC by dispel their worry that joining DAC will undermine their status as recipient countries. It says “We would welcome the sharing of data on concessional flows to developing country partners. Reporting of such flows has no bearing on a country’s status as an aid recipient. Inclusion in the DAC list of ODA recipients is determined solely by a country’s level of economic development based on its per capita income.” Most importantly, it shows its willingness to promote mutual learning by claiming that “We welcome the contribution of all providers of development co-operation resources and expertise, and hope to forge new relationships with these new partners through open dialogue without preconditions.” China attended this Senior High Level Meeting as participants. In the meeting, the delegate from China showed its willingness to engage in dialogue with DAC donors to promote international development co-operation and promised to attend the Busan Conference on aid effectiveness in South Korea in November, 2011.
On April 21, 2011, China issued its first ever white paper on foreign aid. It gives an overall picture of the country's foreign aid activities in the past decades. It notes that under the framework of the South-South cooperation, China will work with all parties concerned to conduct complementary and fruitful trilateral and regional cooperation on the basis of respecting the needs of recipient countries and jointly promote the process of global poverty alleviation. It envisages work on improving aid quality and the “scientific” management of aid projects. It is regarded as a signal for a multilateral approach to aid efforts.

The DAC has already begun a progressive dialogue with China through establishing China-DAC Study Group in partnership with the International Poverty Reduction Centre in China – IPRCC, with the objective of strengthening dialogue and mutual understanding between China and DAC donors.

Through a series of international conferences involving over 500 participants from China, Africa and the donor community, the China-DAC Study Group has focused this exchange and learning on four important topics related to promoting growth and reducing poverty: i) development partnerships; ii) agriculture, food security and rural development; iii) infrastructure; and iv) the enabling environment for enterprise development. In the final summary, it listed What OECD/DAC members can learn from China. It signals three key new directions. First, it emphasizes that development is a learning process and it is important to construct network for adaptive learning and to upgrade the global value chain. State should play an indispensable in promoting economic growth. Thus, it frames their co-operation in terms of the economic transformation process, going beyond aid effectiveness to a wider development effectiveness concept applied to Africa. In this vein, it draws attention to the knowledge transfer in South-South cooperation by saying “maintaining the recent momentum of support for agriculture and infrastructure development, working in relevant forums with emerging countries with special knowledge and expertise” and “examining how aid reporting can better capture the technical co-operation activities of emerging countries in terms their impact, and not just their monetary cost.” Third, it recognizes the role of China’s co-financing in building up Africa’s own dynamics of development. Thus, it signals a new policy direction by “exploring how trade, investment and aid linkages and financing packages can mobilise additional actors and capital for economic transformation processes in Africa.”
This can also be reflected in the Senior High Level Meeting, the current DAC chair, Brian Atwood, emphasized the importance of ‘development related funds.’

Most importantly, it recognizes the value of diversity in donorship by emphasizing “reviewing how comparative advantage, cost structures and complementarities may be shifting among assistance providers as emerging partners build up their aid activities.” The Japanese Professor Ohno also points out the inseparability of content and instruments and the argument for having different approaches rather than everything harmonized.

In addition, there are also changes in bilateral DAC donors. Japan is looking again at aid package approaches used in the 1980s in China and Southeast Asia. The Obama Administration is initiating a pilot project combining USAID and US Ex-Im Bank financing to promote economic growth of recipient countries.

In short, China’s entry into development finance has created unintentional influence on the rules and norms of international aid regime. China has not alone provoked a new debate on whether untied aid is always the optimal development-based approach, whether aid could strike a balance between national interests and development purpose, or whether aid can serve a vanguard role of attracting trade and investment and transfer knowledge and technology for a learning process of development. These tensions and debates may have existed in the past. But China’s development diplomacy has given momentum to the debate by providing alternative ideas and approaches.

If we come back to the initial question of what influence China have upon the international aid regime, the answer is not a “yes-or-no” one—China will obey the existing rules or China will stay out of the rules game. The underlying political dynamics are much more complex. On the one hand, as China’s investment and trade have increased dramatically in Africa, it is in China’s interests to have a stable enabling environment for business. This may form a common ground with other DAC donors. On the other hand, the competition between emerging economies and advanced economies for the market share is becoming more and more intense. The recent reinvigoration of DAC countries’ approach to co-financing packages raises a pressing question as to whether there could be another round crass competition between emerging economies and advanced economies, or the current international rules could be adapted to the changing configuration of power and interests.
Thus, the question is not whether China will comply with the rules or not but how the current international rules might be renegotiated in the context of power shift. Indeed, the creation and reconstitution of the current international rules is by nature a process of political contestation as shown in this article. What is different is that newcomers that gain economic clout become players rather than marginal outsiders. Whether this newly gained economic clout will translate into political influence on rule-making remains an open question for further investigation. Is there a “best outcome” that could be in the interests of the new players that gives them an incentive to join in determining the rules of the game? Interviews with Export Credit Group at the OECD show the latest attitude toward China that “China is now much too large and important in the global trade and trade finance picture to remain outside the multilateral system. This is a view shared by all Arrangement Participant and Export Credit Group (ECG) governments. The OECD, as an organization, as well as these governments, is taking every opportunity to engage China to encourage its cooperation or membership in the export credit work.”

V. Conclusion

The current international aid regime is under the test from emerging powers. China has not set out to challenge the economic regimes intentionally, but the methods of doing and the way of thinking do pose a challenge for established powers to rethink the fundamental questions about what is aid, how aid helps to deliver development outcomes, and how aid is related to other financing instruments.
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