

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT  
Geneva

# ECONOMIC DEVELOPMENT IN AFRICA

## **Doubling Aid: Making the “Big Push” work**



UNITED NATIONS  
New York and Geneva, 2006

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UNCTAD/GDS/AFRICA/2006/1

UNITED NATIONS PUBLICATION

*Sales No.* E.06.II.D.10

ISBN 92-1-112702-5

ISSN 1990-5114

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## Explanatory notes

The \$ sign refers to the US dollar.

**Sub-Saharan Africa (SSA):** Except where otherwise stated, this includes South Africa.

**North Africa:** Unlike in the UNCTAD Handbook of Statistics, in this publication Sudan is classified as part of sub-Saharan Africa, not North Africa.

## Abbreviations

ADF	African Development Fund
AfDB	African Development Bank Group
AU	African Union
BWI	Bretton Woods institution
CFA	Commission for Africa
CPIA	Country Policy and Institutional Analysis
DAC	Development Assistance Committee (OECD)
DFID	Department for International Development (UK)
ECA	Economic Commission for Africa
EEC	European Economic Community
EIB	European Investment Bank
EU	European Union
FDI	Foreign direct investment
FFD	Financing for development
GDP	Gross domestic product
GFATM	The Global Fund to fight AIDS, Tuberculosis and Malaria
GNI	Gross national income
G8	Group of Eight
HIPC	Heavily Indebted Poor Country Initiative
IBRD	International Bank for Reconstruction and Development (World Bank)

IDA	International Development Association (World Bank)
IFI	International finance institution
ICF	Investment Climate Facility for Africa
IMF	International Monetary Fund
MDGs	Millennium Development Goals
NEPAD	New Partnership for Africa's Development
NGO	Non-governmental organization
OAU	Organization of African Unity
ODA	Official development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PRGF	Poverty Reduction and Growth Facility (IMF)
PRSP	Poverty Reduction Strategy Paper
SAP	Structural adjustment programme
SSA	Sub-Saharan Africa
SWAP	Sector-wide approach
UK	United Kingdom
UNDP	United Nations Development Programme
US	United States of America
USAID	United States Agency for International Development

## A. Overview

After two decades of adjustment without growth, there are, at last, some real signs of improving economic performance in Africa. Not only has growth steadily accelerated since the turn of the century, but new trade and investment opportunities, particularly arising from increasing demand in emerging markets such as China and India, hold out hope that this time around it might be sustained. Ongoing efforts at macroeconomic and political reform have been consolidated in many countries, and the launch of the New Partnership for Africa’s Development (NEPAD) signalled a willingness on the part of African leaders to confront past mistakes but also to be held accountable for their side of the development bargain. Real progress has also been recorded at the international level on issues such as debt relief and public health and education, which will have a direct bearing on poverty reduction prospects. Perhaps most encouraging of all, the international community, after retreating in the 1990s, has recovered its faith in official development assistance (ODA), with a promise to double aid to Africa by 2015. With the Cold War a fading memory, hopes are high that this aid will not be distorted by political calculations.

However, it would be unwise to lose sight of the magnitude of the challenge. The continent is already behind on meeting the Millennium Development Goals (MDGs) and getting back on track implies, on some estimates, sustained growth of 8 per cent annually for the next decade, well above this year’s expected growth of gross domestic product (GDP) of over 5.5 per cent for the continent as a whole. Although high energy and mineral prices have brought large gains to some African countries, increasing average growth rates, so far there has been little impact in terms of reducing poverty and inequality and raising employment. Industrial development remains subdued, at best, while at the same time policy makers in a growing number of countries are having to confront a whole new series of challenges linked to a rapidly expanding urban population.

It is also the case that fresh starts for the continent are nothing new. In the late 1970s, when the region was already exhibiting clear signs of economic slowdown, the Organization of African Unity (OAU) produced the Lagos Plan of Action, a far-reaching reassessment of Africa’s links to the global economy. It put the responsibility for the continent’s problems, and for finding solutions to them,

firmly on the shoulders of African policy makers. The proposed reform agenda, however, was sunk by the combined forces of global economic slowdown and declining commodity prices, leading to a severe debt crisis which engulfed the entire region in the early 1980s. Struggling under severe balance of payments constraints and under considerable pressure from the international financial institutions, aid and loans were extended on condition that countries adopt structural adjustment programmes (SAPs) that would supposedly enable their economies to withstand and benefit from the competitive pressures of a global economy. Instead, the steady worsening of poverty and human development indicators across Africa has forced a rethink by the international community.

With the current proposals to double aid, the credibility of both donors and recipients has been pinned on forming genuine partnerships to “make poverty history” with the MDGs providing a clear reference point and time frame for judging progress. However, there are already signs of slippage. Civil society groups have raised some awkward questions about the inclusion of debt relief as part of the promised increase in aid, about the real volume of aid actually received and about the concentration of flows on a relatively small number of countries. There are also very clear signals that security concerns and energy politics are again shaping the policy debates on aid and development; another scramble for African resources, however, is no more likely to generate a successful development path than in the past. There are, most worryingly of all, growing concerns about the effectiveness of NEPAD as a reliable development framework, along with persistent worries about whether African elites are willing to forsake short-term rent-seeking behaviour for longer-term commitments to productive investments. It would be a mistake for governments to treat these concerns lightly, lest the seriousness of their commitment be questioned by the public in both the donor and receiving countries. All deserve more careful thought and immediate attention in order to highlight the urgency of fully exploiting the current mood of optimism in order to avoid any resurgence of bearish attitudes towards aid.

\* \* \*

Six years ago, UNCTAD called for a doubling of aid to Africa, a call subsequently picked up and amplified by the High-level Panel on Financing for Development, the Monterrey Consensus, the Practical Plan to Achieve the Millennium Development Goals (the “Sachs Report”), the Report of the Commission for Africa (CFA), set up by the British Prime Minister Tony Blair, and the World Summit.



New life has been breathed into the aid target of 0.7 per cent of developed countries' gross national income (GNI) (initially recommended by UNCTAD and subsequently adopted by the United Nations) with some major donors agreeing a timetable for its achievement. Of course, even if aid were to reach these levels, there can be little doubt that a secure economic future for Africa will hinge on the effective mobilization and investment of domestic resources. In the coming years, the debates about development finance will revolve around the search for a successful blend of resources from various sources, strengthening institutional capacity and improving policy coherence.

While a “big push” designed to instigate a virtuous circle of higher rates of savings, investment and economic growth is necessary for a permanent reduction in poverty, the quality of both the aid supplied by donors and the policies pursued by recipients are critical factors for success and for eventually ending the need for aid. The impact of ODA, however, as UNCTAD earlier insisted, cannot be separated from the wider issue of choosing an appropriate development strategy to realize the annual growth rates estimated to be necessary for meeting the MDGs in Africa. On any objective assessment of two and a half decades of standardized packages of “stabilization, liberalization and privatization”, the right kind of growth path has simply failed to materialize across most of the continent.

This is all the more reason to forge a new consensus on ODA. Moving ahead is certainly not helped by the tendency to polarize the aid debate, in which sceptics continue to return to a series of basic issues, such as promoting market principles in the raising and delivery of funds, questioning the absorptive capacity of recipients, and raising issues of incentive distortion, including those associated with “Dutch Disease” and fungibility problems. Some of these concerns are legitimate, but analysis and empirical evidence provided by academics, non-governmental organizations (NGOs) and the international community, while not conclusive, suggest that they are often exaggerated. A case in point is the risk of Dutch Disease, which is less a matter of insurmountable constraints on absorptive capacity and more a question of effective macroeconomic management of aid and designing development strategies tailored to local conditions. This was the conclusion of the African Ministers of Finance Conference on Financing for Development meeting this year in Abuja, based on discussions that included experts from the multilateral financial institutions.

Many useful lessons can be drawn from the history of aid in designing contemporary strategies that aim to advance its developmental impact. Both positive and negative outcomes need to be analyzed in their proper context and taking into account the many variables – economic, social and political – which might help to explain the causes of the various examples of success and failure. It is certainly in the interests of donors and recipients alike to undertake an unbiased assessment of past policies, identifying their shortcomings and making changes to ensure that the promised increase in aid will have a positive influence on growth, development, and the reduction of poverty.

In 1947, Senator Dirksen famously dubbed the Marshall Plan as “Operation Rat-Hole”, into which the United States (US) taxpayers’ money would disappear with little prospect of returns to the donor. He was proved spectacularly wrong and the Marshall Plan still stands as perhaps the most successful aid exercise in history. This report still sees valuable lessons in this experience. But it is not an isolated case. Ireland and Portugal received massive amounts of aid following their membership of the European Economic Community (EEC): transfers reaching as much as 5 percent of their respective GDPs and continuing for a decade or more were comparable in scale to Marshall Aid. Europe, however, is not the only part of the world where there have been success stories with aid. The East Asian miracle economies, notably the Republic of Korea and Taiwan Province of China, received enormous amounts of aid during the initial and early stages of their development, the assistance lasting well into the 1960s. In Africa, both Botswana and Mauritius received very large amounts of aid at key strategic moments in their development as, earlier, did Tunisia. These examples show that large amounts of well-targeted aid have produced some remarkable success stories in terms of growth and overall development. Aid directed at specific problems has also often proved to be highly effective: health programmes for example, have significantly reduced infant and under-five mortality rates, eliminated river blindness, and put an end to smallpox.

Despite all this, however, the sceptics remain prominent, if no longer dominant, in public debates about aid. Africa is often held up as a prime example of wasted aid. This view is usually buttressed by reference to econometric evidence that takes little or no account of structural deficiencies, policy constraints, and the inefficiencies of the aid donors themselves, including the quality of aid, its quantity, unpredictability, political instrumentality and, indeed, its very definition. In short, scepticism about the value of aid rests to a large degree on selective economic reasoning and questionable interpretation of economic history.

One reason why aid has not always succeeded in accelerating growth and development is that these have not always been among its objectives. But, as spelt out in past UNCTAD reports on Africa, even when they have, as with adjustment programmes, the links have been poorly thought through, have failed to accommodate local conditions, and all too often have been guided by a search for quick economic fixes.

Another major source of the inefficiency and ineffectiveness of much aid is the lack of coherence among donors and their objectives and requirements, and a failure to reconcile these with the needs, priorities and preferences of the countries receiving assistance. The sheer multiplicity of donors, with different outlooks, accounting systems and priorities have created a landscape of aid that, at best, can only be described as chaotic. This has in turn stretched the administrative capacities of the recipient countries to breaking point and undermined any pretence of local ownership of development programmes. The institutional capacities of the receiving countries have been further weakened by the pressures to reduce the size and functions of the state, a prominent feature of the adjustment programmes driven by international finance institutions (IFIs). The situation is exacerbated by the presence of numerous new bodies such as NGOs through which aid is often disbursed with little or no oversight by the recipient government or other national institutions. Coping with such a situation would stretch the abilities of the bureaucracies of the Organisation for Economic Cooperation and Development (OECD) countries, let alone those of poor African states.

The sectoral distribution of aid is also greatly influenced by donors' preferences and the different criteria applied by them. With increasing attention by the international community being given to poverty indicators, there has been a major shift in the allocation of aid from infrastructure, agricultural development and energy supply to social expenditure. This is an issue that African Ministers of Finance have raised on several occasions. Their concerns are centered on whether such expenditure can be sustained in the absence of growth-oriented, productive investment. In implementing the proposed increase in aid, both its growth-enhancing and social development goals will need to be carefully balanced in order to ensure that higher rates of economic growth can be sustained in order to reduce aid dependency in the longer-term and ensure that the reductions in poverty are irreversible.

Recent initiatives such as the 2005 Paris Declaration on Aid Effectiveness are *ipso facto* recognition of the serious shortcomings in the way that the international aid system has been operating. The recommendations of the Declaration can indeed be helpful in raising the quality and effectiveness of aid. Nevertheless, if donors' recognition of the need for greater local ownership of aid programmes is to be taken at face value, the de-politicization of aid, greater policy space for the recipients of aid and less intrusive policy conditions are all prerequisites for ensuring that aid results in more positive outcomes. In order to attain these objectives, there needs to be a greater multilateralization of aid so that the distorting influence of individual donor preferences is reduced. Such a shift in the balance of bilateral and multilateral aid should also help to simplify delivery by providing greater coherence, transparency and accountability; transaction costs should be lowered, the predictability of disbursement greatly improved and the demands on recipient institutions considerably reduced.

\* \* \*

A greater multilateralization of aid can help to reduce unnecessary and costly competition (and associated fragmentation) among donors, and thus greatly reduce administrative costs. It can also provide a buttress against the politicization of aid which has been so damaging in the past. But there also needs to be reform of the existing multilateral institutions that currently provide aid on condition that the recipient country adopts policies acceptable to (and usually formulated by) the international financial institutions. The nature of the current Poverty Reduction Strategy Paper (PRSP) process does not lend itself to the longer-term planning that will be required if a doubling of aid is to be employed to maximum effect. The time is perhaps right to revisit the idea, first broached in the mid-1950s, of a UN funding window for African development.

A new international architecture for aid must ensure, first and foremost, that it is used to encourage and supplement national resource mobilization and to fill the gap between national rates of saving and the rates of investment required to meet national development goals, including the MDGs. There is now greater recognition of the need for aid to be increasingly used for budget support, thus implying that it should be seen as part of a comprehensive fiscal and financing package for the implementation of national programmes and priorities and, as such, that it should be subject to parliamentary oversight and scrutiny in the recipient countries. Such a process will reinforce both the ownership of national programmes and the accountability of governments to their national

constituencies rather than to foreign donors or multilateral financial institutions. This is one way in which the organization of aid can help to reinforce democratic processes, strengthen the rule of law and reduce the possibility of aid being captured by corrupt elites, all of which are among the declared aims of donors and recipients alike. A shift to budgetary support does not necessarily imply the abandonment of project support and technical assistance, but they should only be provided in response to express demands from recipients to fill specific institutional lacunae. In particular, post-conflict situations may often require a combination and sequencing of different delivery techniques in order to begin the reconstruction of state and institutional capacities, as will cases where the local elites have a record of capturing the rents arising from aid rather than investing in productive capacity.

Recalling one of the most successful aid programmes of the past, both the British Prime Minister and his Chancellor of the Exchequer have called for a Marshall Plan for Africa. Although the problems of reconstruction in post-war Europe were very different from the problems of development facing Africa today, the differences should not be allowed to obscure the fact that many of the features of the Marshall Plan that helped to make it a success point to useful lessons that can inform the creation of a new aid architecture. These include recognition that shock therapy was neither politically or economically feasible in engineering a return to a system of free trade and payments and dismantling the apparatus of state control that had developed over the course of nearly a decade; that piecemeal approaches to aid had not stimulated recovery and that a more coordinated approach was required with each beneficiary state drawing up a four-year plan for recovery; that such plans should be drawn up by the countries themselves without outside interference; that aid would be released in tranches dependent on intermediate targets being met; that conditionality was essential, but it had to be applied in a more flexible manner and over a long time-horizon; that trade liberalization would be gradual and asymmetric, with the US providing greater market access more rapidly than the Europeans; that the aid package was generous with a large grant element; and that the European countries were expected to cooperate among themselves and the aid programme was to be coordinated in a regional body.

The Marshall Plan recognized that investing in structural change required providing the recipient countries with sufficient breathing space and flexibility to bring often difficult and painful policies to fruition. This report does not pretend that the Marshall Plan can be replicated in detail for Africa, but there is no doubt

that the processes and organizing principles that governed the Plan suggest a much better and more coherent model than is currently available for addressing many of the problems and issues surrounding aid delivery and impact. In particular, by requiring the potential recipients of aid to produce coherent development plans, indicating how and where they would use aid to achieve their objectives in a given time-frame would help to eliminate much of the present chaos surrounding aid delivery. Also, by subjecting the coherence and feasibility of such plans to peer review and coordination in a regional forum, donors would become more sensitive to the recipients' objectives rather than the reverse. This, in turn, would give real meaning to the concepts of partnership and ownership.

This report discusses these issues in some detail in the light of the commitments to increase substantially the volume of aid to Africa, and on the assumption that these promises will be kept. It presents a perspective that departs from the current modalities governing the supply and uses of aid and insists that major reforms in institutions and current practice are essential if a "big push" for African development is to be really successful, putting an end to aid dependency.

## B. Aid to Africa

### 1. Aid in historical perspective

While the case for giving aid to low-income countries can be made on purely economic grounds, in practice it has been heavily influenced by the commercial and political calculations of donors. Moreover, in the minds of many politicians and much of the public in donor countries, aid is seen less as a matter of accelerating economic development and more as a humanitarian gesture to less fortunate people. All these motives, in various permutations and with shifting emphasis over time, are reflected in the history of official development assistance over the last 60 years (table 1).

The origins of modern aid can be traced to the colonial period. Specifically, the British Colonial Development Act of 1929 provided for grants and loans to colonial governments to meet their infrastructural needs as well as enabling them to pay for imports.<sup>1</sup> However, such aid was firmly subordinate to the economic and political interests of the “metropole”. The emphasis only began to change with the shift in international political and financial leadership from the old colonial powers, both at the global level (with the ascendancy of the United States during World War II) and at the local level (with the growing number of successful movements for independence), allowing aid to acquire a more purposeful development rationale (on the analytical problems regarding the measurement of aid, see box 1). This rationale was initially advanced by the Bretton Woods Conference, which institutionalized the logic of multilateral economic rules and financial support, the success of the Marshall Plan and the creation of the United Nations (with universal membership). The objective of both the Marshall Plan and the newly formed World Bank, however, was the reconstruction of war-torn Europe and not the development of the poor, non-industrialized, developing countries (see table 1 and section E for a discussion of the Marshall Plan). The needs of developing countries were more openly acknowledged in the inaugural address of President Truman in 1949, when he declared the objective of “making the benefits of our scientific advance and industrial progress available for the improvement and growth of underdeveloped areas” (Kanbur, 2003). This was followed by the 1950 Act of International Development which established “the policy of the United States to aid the efforts of the peoples of economically underdeveloped areas to develop their resources and improve their living conditions” (Ohlin, 1966: 25).

Table 1

## SCHEMATIC OVERVIEW OF MAIN DEVELOPMENTS IN THE HISTORY OF FOREIGN AID

	<i>Dominant or rising institutions</i>	<i>Donor ideology</i>	<i>Donor focus</i>	<i>Types of aid</i>
1940s	Marshall Plan and UN system (including World Bank).	Planning.	Reconstruction.	Marshall Plan was largely programme aid.
1950s	United States, with Soviet Union gaining importance from 1956.	Anti-communist but with role for the state.	Community Development Movement.	Food aid and projects.
1960s	Establishment of bilateral programmes.	As for the 1950s, with support for state in productive sectors.	Productive sectors (e.g. support to the green revolution) and infrastructure	Bilaterals gave technical assistance (TA) and budget support; multilaterals supported projects.
1970s	Expansion of multilaterals especially World Bank, IMF and Arab-funded agencies.	Continued support for state activities in productive activities and meeting basic needs.	Poverty, taken as agriculture and basic needs (social sectors).	Fall in food aid and start of import support.
1980s	Rise of NGOs from mid-1980s.	Market-based adjustment (rolling back the state).	Macroeconomic reform.	Financial programme aid and debt relief.
1990s	Eastern Europe and former Soviet Union become recipients rather than donors; emergence of corresponding institutions.	Move back to the state towards end of the decade.	Poverty and then governance (environment and gender second order focus).	Move toward sectoral support at the end of the decade.
2000s*	OECD, Commission for Africa, EU, proposed IFF, IMF/World Bank.	Enhanced effectiveness through donor coordination and policy harmonization, PRSPs.	MDGs/poverty reduction (emphasis on health, education and water), local ownership.	Increased technical cooperation and social sector support; move towards SWAPs and budget support.

Source: Hjertholm and White (2000: 81, table 3.1).

Note: Entries refer to main features or changes; there are, of course, exceptions.

\*UNCTAD's addition.



The growing willingness to extend aid to developing countries coincided with a flurry of new ideas about why economic activity should not be left entirely to market forces and with a search for better ways for policy makers to manage competing economic goals and trade-offs, particularly in a more open economic environment. While much of this thinking was aimed at the policy challenges facing the more advanced industrial economies, it had a profound impact on the evolving discussions of aid and development, with the United Nations in the forefront of efforts to establish a more balanced framework embracing both donors and recipients (Toye and Toye, 2004). Albeit with subsequent modifications and embellishments, the economic case for extending aid to poorer countries still largely rests on the growth and gap models of the 1950s and 1960s.<sup>2</sup> These suggest that aid, by providing an initial boost to domestic capital formation and incomes, can raise domestic savings in both the corporate and household sectors thereby invigorating an investment-export nexus that will eventually close the gap between domestic resources and the supply of foreign exchange. Over time, growth and development should become self-sustaining and the need for aid disappear. Behind this thinking was the conviction that aid would be most effective if donors were guided by enlightened self-interest (whereby support for industrial development in poor countries would bring positive spillovers in terms of trade and investment opportunities) and if recipient governments were similarly guided by a development compact (whereby short-term pressures to raise consumption, both public and private, were resisted in favour of long-term commitments to boost productive investment). The logic of this thinking was a multilateralization of aid.

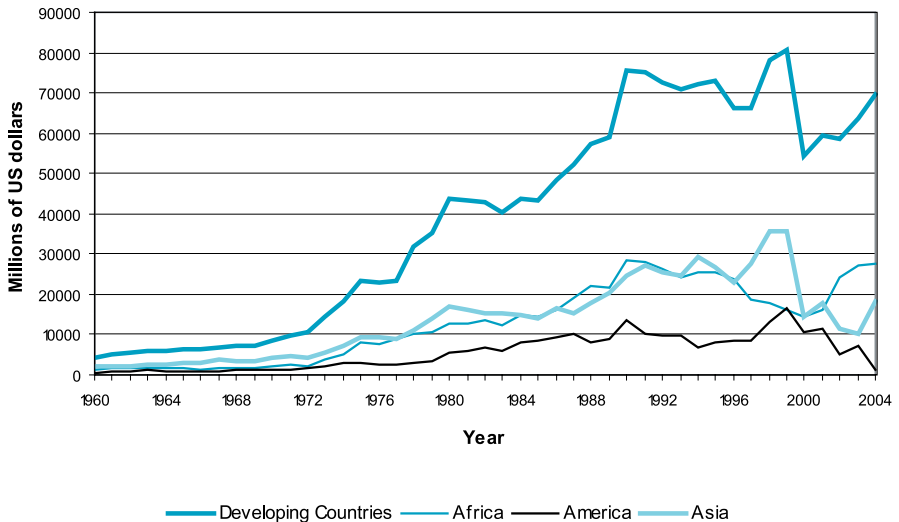
However, when aid did begin to increase to developing countries in the 1950s, it was principally for strategic and political reasons. The process was led by the US, with about half of its bilateral assistance in the 1950s and 1960s going to the Republic of Korea, Taiwan Province of China and South Viet Nam, the last being the largest recipient (CBO, 1997; Radelet, 2003). In Africa, aid was closely linked to the process of decolonization, the erstwhile colonial powers mixing a moral obligation to support their former colonies with a desire to retain both political influence and access to natural resources and markets. These relationships have been remarkably resilient: the two major, former colonial powers, France and the UK, still accounted for about one-fifth of total aid to Africa during 1980–2000 (a steep fall compared to one-half of total aid in the late 1960s) and remain eager to provide technical assistance which is frequently linked to the supply of skills and services from the donor country.<sup>3</sup>

Foreign aid has thus been principally a tool of “statecraft”, employed to encourage or reward politically desirable behaviour on the part of recipients (Lancaster, 1999: 1). While this is not necessarily incompatible with broader development goals, the politicization of aid has often been associated with a “softening” of state structures that have perpetuated or worsened highly inegalitarian economic and social structures in the recipient countries (Myrdal, 1970).<sup>4</sup>

The subordinate role of development goals in shaping the direction and composition of aid was maintained at least into the early 1980s (Kanbur, 2003: 4). That changed following the international debt crisis, when aid was used more overtly to encourage specific economic reforms in the context of SAPs. At the beginning of the 1990s, the collapse of the Soviet Union raised hopes that increased aid would be part of the dividend from the end of the Cold War and that geo-political calculations would at last begin to be subordinate to economic assessments of the most effective use of aid.

What actually occurred, however, was that the removal of the underlying strategic rationale for providing aid, combined with an ideological shift in many donor countries to diminish the role of the state in managing economic activity, led to a significant decline in its volume<sup>5</sup> (figure 1). After almost a decade of aid apathy (if not antipathy), a series of international conferences in the early years of the twenty-first century revived the rationale for development assistance. In September 2000, all member states at the UN Millennium Summit pledged to reduce world poverty by signing up to the MDGs. Subsequently there were a series of related meetings including the UN Financing for Development (FFD) Conference in Monterrey, Mexico in March 2002 (UN, 2002) and the High Level Forum on Harmonization in Rome in February 2003, followed in rapid succession by the High Level Forum on Aid Effectiveness in Paris (February/March, 2005), the Group of Eight (G8) Heads of States Meeting in Gleneagles, Scotland in July 2005 and, in September of the same year, the UN World Summit in New York.

Figure 1

GEOGRAPHICAL DISTRIBUTION OF AID TO DEVELOPING COUNTRIES,  
1960–2004

Source and notes: as for Table 2.

These efforts have raised hopes that broader development goals, undistorted by narrow political calculations, might return to the top of the aid agenda. Other considerations, however, have since had an increasing influence on the proposed agenda. These range from heightened concerns about terrorism and threats to security (Natsios, 2006),<sup>6</sup> to a growing emphasis by some donor countries on “global public goods”. For others, the agenda has been closely tied to the debt relief campaign initiated by NGOs and other civil society organizations resulting in the Heavily Indebted Poor Country Initiative (HIPC), the associated poverty reduction strategy papers (PRSPs) and to the idea of countries “trading their way out of poverty”.<sup>7</sup> These issues are not unimportant or irrelevant, but the danger is that the case for doubling aid to Africa will once again be enmeshed in a tangle of proliferating objectives and fragmented interests and, as in the past, this is likely to dilute considerably, or even undermine, its impact on economic development (section D).

## 2. Some summary statistics

Since 1960, Africa has received \$580 billion in aid. On the face of it, this appears to be a very large sum, but it is important to place it in a broader economic and political perspective (on some of the analytical problems regarding the measurement of aid, see box 1).

### Box 1

#### MEASURING REAL AID VOLUMES: ANALYTICAL PROBLEMS

The problems with the data on aid have been dealt with extensively in the aid literature and a detailed analysis of their quality is unnecessary in this report. Nonetheless, it is essential to point out to the reader some of the major reservations regarding the data.

According to the Development Assistance Committee (DAC) of the OECD, official aid or ODA refers to "... grants and loans to developing countries and territories which are: (i) undertaken by the official sector of the donor country; (ii) with the promotion of economic development and welfare in the recipient country as the main objective; and (iii) at concessional financial terms (i.e. if a loan has a grant element<sup>a</sup> of at least 25 per cent)". This generally accepted definition excludes concessional flows of private voluntary organizations and official flows with little or no concessionality. Grants, soft loans and credits for military purposes are also excluded. However, there are difficulties with this definition, and some analysts include non-concessional loans from the World Bank in ODA, while others include IMF loans whether concessional or not. Most analysts, however, often ignore the fine distinctions between the various forms of financial flow to developing countries.

There is only one major comprehensive source of aid data and that is the OECD. While the World Bank and other international organizations rely on OECD data for their own publications, there can be considerable differences between the data in their reports and those published by OECD. The latter's data are collected from member countries and cannot be verified by recipient countries due to the fact that some expenditure, such as technical assistance and research and payments to contractors in the donors' own country, do not enter the recipient governments' records. Thus, independent verification of the data is difficult, if not impossible.

DAC figures are based on data from donor countries and agencies and on agreed definitions of what should be included. As pointed out by Riddell (1987), however, it cannot be assumed that the value of aid specified by donors is equal to that which arrives in, or is utilized by, the recipient countries. In addition to the statistical discrepancies noted above, this is because inefficiencies in the aid system imply that the actual resource flows available for development are effectively much lower than their nominal value. Aid for development is also "lost", as more and more aid is

**Box 1 (contd.)**

diverted to activities not directly focused on poverty reduction or development, such as debt relief and over-priced and ineffective technical assistance, among others. That is, “real aid” is much smaller than is suggested by the statistics of its nominal value.

In a recent study, ActionAid estimates that in 2003, about 60 percent of all bilateral donor assistance was “phantom aid” – that is, aid that “never materializes for poor countries, but is instead diverted for other purposes within the aid system”.<sup>b</sup> Thus, real aid in 2003 accounted for just \$27 billion (or 0.1 per cent of the combined income of donors) (ActionAid, 2005: 17). Estimates vary of the direct costs of tied aid, in terms of the implied reductions in the actual value of total bilateral aid, but they could have been as much as \$5–\$7 billion in 2002 according to the OECD (UN, 2005a: 121; Menocal and Rogerson, 2006: 19); about 45 per cent of all bilateral aid remained tied in the same year (Menocal and Rogerson, 2006: 19). Overall, the cost of tied aid alone is estimated at some \$2.6 billion per annum for low-income countries, equivalent to a tax of about 8 per cent, costing Africa about \$1.6 billion a year (UNDP, 2005: 76). Furthermore, there are technical questions regarding the definition and measurement of aid itself. Net ODA refers only to grants and net disbursements and therefore excludes interest payments, an omission which produces an overstatement of net transfers to the recipients. Finally, aid combines aggregate grants with concessional loans even though their net discounted values to the recipient are very different (O’Connell and Soludo, 1998).

- a This reflects the financial terms of a commitment, namely, interest rate, maturity and grace period. The concessionality of a loan is the difference between the present value of the actual interest charged on the loan and what it would have been had it borne the market rate of interest.
- b As defined by ActionAid, phantom aid includes all aid that is: not targeted for poverty reduction, double counted as debt relief, overpriced and ineffective (e.g. technical assistance), tied to goods and services from the donor country, poorly coordinated with high transaction costs, too unpredictable to be useful to the recipient, spent on immigration-related costs in the donor country and spent on excess administration (ActionAid, 2005: 17).

*Aid to Africa has not been exceptionally large...*

Aid to Africa, whether measured in nominal or real terms, was essentially stagnant until the early 1970s when renewed Cold War tensions led to an increase, particularly to countries in North Africa. Flows, linked to IMF/World Bank adjustment programmes, continued to rise throughout the 1980s but with a marked shift in their direction to sub-Saharan Africa (SSA). The share of SSA in global aid increased steadily from 16 per cent in 1974 to 28 per cent in 1992 (reaching almost \$21 billion). There was then a sharp downturn lasting until 2000 (with aid falling below \$12 billion) followed by a recovery in 2002 that surpassed

the earlier peak. Few countries in SSA escaped the downturn in the 1990s, only three receiving more aid in 1999 than in the late 1980s.

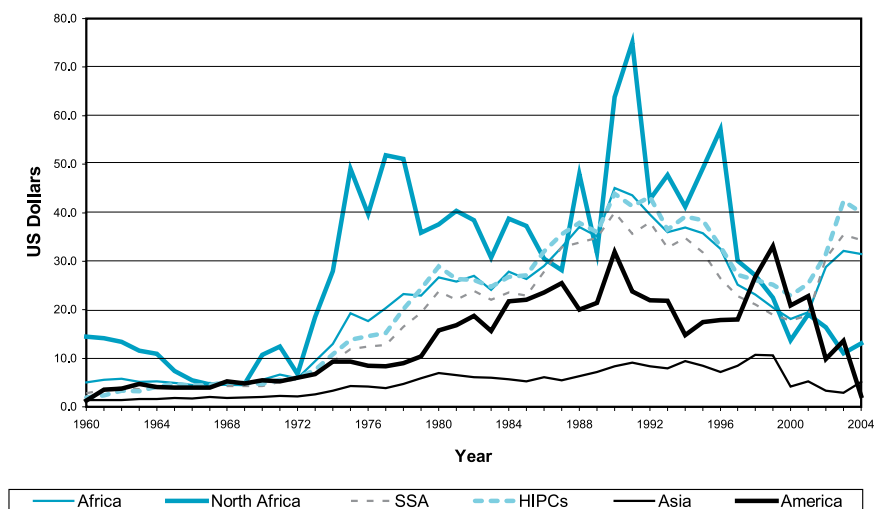
Aid to the region has been predominantly bilateral. Multilateral aid to SSA increased from just under one-fifth of the total in the 1970s to close to 40 per cent in the early 1990s (when multilateral assistance held up better than bilateral flows) before declining again.<sup>8</sup> The recent recovery of aid to the region has had a larger multilateral component, its share rising to around 30 per cent of the total, largely because of the increased weight of debt relief (and despite the principle that debt relief would be additional to aid) (World Bank, 2003, table 3.1; UN, 2002).

Although popular sentiment in the donor countries tends to associate aid as largely a response to African needs, aid to Africa (in current prices) has generally been much lower than that to Asia. Between 1960 and 2004, Asia received some \$40 billion more in aid than Africa. Almost half of global aid went to Asia compared with about a quarter to Africa during the 1960s; Asia's share of aid from all donors and from DAC countries alone (40 and 36 per cent respectively) was more than that of Africa (about one-third in both cases) during the 1990s. Africa's share (37 per cent) of DAC aid only surpassed Asia's (30 per cent) in the 1980s and even then their shares of global aid were the same (34 per cent). It was not until the early 2000s that Africa's share of global aid (36 per cent) was significantly higher than Asia's (about a quarter) (figure 1).

Aid is more significant for Africa when measured on a per capita basis or as a ratio of gross domestic income. Between 1960 and 2004, Africa received \$24 of aid per capita, more than double the developing country average of \$11, the difference being greatest in the late 1980s (table 2). Despite the sharp increase in nominal flows after 1974, however, the real value of aid to SSA was declining from the early 1980s (UNCTAD, 2000a, chart 2). The average figure also hides large inter-country variations in ODA per capita, sometimes differing by a factor of more than 20 for countries with the same per capita income (UNCTAD, 2000a, chart 4). Moreover, very few African countries have been treated as generously as the major aid recipients in Asia and Europe. Thus, although average per capita aid to Asia was the lowest in the developing world (figure 2 and table 2), the Republic of Korea, Taiwan Province of China and South Viet Nam received almost double the amount for Asia as a whole between 1960 and 1979<sup>9</sup> (table 2 and box 2).

Figure 2

## NET ODA PER CAPITA, DEVELOPING COUNTRIES AND HIPCS, 1960–2004



Source and notes: as for Table 2.

Table 2

 AID PER CAPITA, DEVELOPING COUNTRIES, 1960–2004  
 (Period average, current US dollars)

	1965-2004	1965-1969	1970-1979	1980-1989	1990-1999	2000-2004	1985-1994	1995-2004
Developing Countries	1.3	1.6	1.9	1.9	1.5	0.9	1.9	1.1
Africa	3.8	2.6	3.7	4.3	5.0	3.6	5.5	3.8
North Africa	2.8	4.0	6.2	3.2	3.6	0.9	3.8	1.7
SSA	4.2	2.2	2.8	4.7	5.5	4.8	6.1	4.7
America	0.6	0.7	0.7	1.0	0.7	0.4	0.9	0.5
Asia	0.8	1.5	1.5	1.2	1.0	0.3	1.2	0.6
<b>Memo Item:</b>								
HIPCs	8.3	2.7	5.2	8.8	11.6	10.5	11.4	10.3

Source and notes: as for Table 2.

As a share of GDP, aid to Africa averaged 3.8 per cent between 1965 and 2004, almost three times the developing country average. The share was rising throughout the period, reaching 5 per cent in the 1990s, largely reflecting the worsening economic situation of the region. In North Africa, aid to GDP ratios had been even higher during the 1960s and 1970s (4.0 and 6.2 per cent respectively), thanks to large amounts of US bilateral assistance to Egypt, Morocco and Tunisia, but the figure fell sharply thereafter. Aid to SSA peaked in the 1990s at 5.5 per cent of GDP but, despite the subsequent rise in nominal flows, the share has

since fallen thanks to the recovery in economic growth. Increased debt relief to the HIPC's has more than doubled their aid to GDP ratio to about 11 per cent (1990–2004) (table 3).

**Table 3**  
**AID TO GDP RATIO, DEVELOPING COUNTRIES, 1965–2004**  
*(Period average, percentages)*

	1960-2004	1960-1969	1970-1979	1980-1989	1990-1999	2000-2004	1985-1994	1995-2004
Developing Countries	11.4	2.7	6.8	13.2	16.8	12.6	15.8	14.3
Africa	24.3	5.0	14.9	29.5	33.3	26.2	36.4	26.7
North Africa	30.5	8.9	31.4	36.1	45.0	14.6	45.0	25.3
SSA	22.2	4.0	10.8	27.1	29.8	27.6	33.6	26.0
America	15.3	4.0	7.9	20.2	22.7	13.7	22.6	18.1
Asia	5.4	1.7	3.6	6.1	8.9	4.2	7.4	6.6
<b>Memo Items:</b>								
HIPCs	25.7	3.9	12.8	30.4	35.0	32.7	37.5	31.3
K T V	5.3	4.2	6.8	2.1	11.2	-1.4	-3.5	11.0

Source: UNCTAD secretariat computations based on OECD and World Bank online databases.

Note:

SSA: Sub-Saharan Africa

HIPCs: Heavily Indebted Poor Countries (African)

K T V: Korea, Rep + Taiwan, Province of China + Viet Nam.

Aid includes net official development assistance (ODA) and other official flows (OOF).

ODA net consists of bilateral grants and bilateral loans.

*...but it has been highly erratic since the early 1990s,*

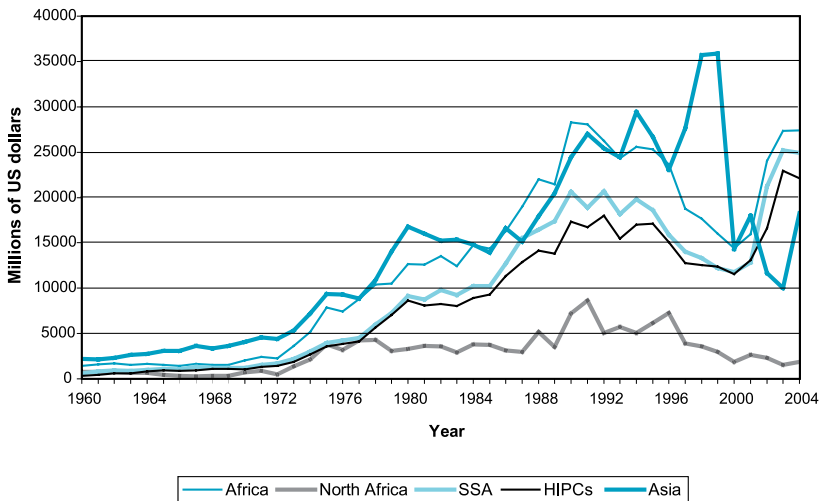
Aid to Africa needs to be predictable for policy makers, but in reality it has generally been highly volatile, and more so than for other developing countries (table 4). Indeed, since aid flows are large relative to other macroeconomic variables, such instability can lead to wider instability with negative consequences for domestic resource mobilization and growth prospects (section D.1(a)). A previous UNCTAD study compared the coefficient of variation of annual changes in aid flows with government revenues and export revenues for a number of poor countries, 17 of which were in Africa, between 1970 and 1998 (UNCTAD, 2000a, table 40). In all the African cases, with the exception of Uganda, aid was more volatile than government revenue, in many cases three to four times so. The picture is more varied with export revenues, with aid less volatile in 10 of 17 countries. Flows were least variable during the 1990s but this was also a period when aid fell sharply to levels previously seen in the mid-1980s (figure 3). The recovery since then has again coincided with greater volatility. A number of factors appear to be responsible for this.



The erosion of traditional strategic and ideological reasons for aid may be one. Reductions in aid budgets due to fiscal stringency in donor countries and a deep recession in Japan, a major donor, may be another. There was also increased competition for the available resources from non-traditional recipients. For example, in 1999, Eastern Europe and Central Asia received more aid per capita than Africa – \$23 as opposed to \$20 (Degnbol-Martinussen and Engberg-Pedersen, 2003: 236). The recent recovery in the flow of aid is largely the result of increased debt relief, and as this is likely to be more sporadic in nature, it may also increase measured volatility in the short-run (Gupta, Patillo and Wagh, 2006: 20). Volatility is not unique to aid: other sources of foreign exchange, such as export revenues and private capital, including FDI, are also very volatile but what is perhaps surprising is that there is little evidence of aid offsetting the instability of these other variables (section D.1(a)).

**Figure 3**

**GEOGRAPHICAL DISTRIBUTION OF AID TO AFRICA BY MAJOR REGION AND HIPCS, 1960–2004**



Source and notes: as for Table 2.

*...and is concentrated on just a few countries.*

Aid is also highly concentrated, although less so than private capital flows such as FDI. While the share of the 10 largest aid recipients in Africa increased from 35 per cent (1985–1994) to almost 40 per cent (1995–2004) (table 5), the

Table 4

VOLATILITY INDEX OF AID\* TO DEVELOPING COUNTRIES, 1960–2006  
(Coefficient of variation)

	1960-2004	1960-1969	1970-1979	1980-1989	1990-1999	2000-2004	1985-1994	1995-2004
Developing Countries	0.66	0.14	0.44	0.13	0.06	0.09	0.18	0.12
Africa	0.72	0.05	0.53	0.22	0.18	0.26	0.20	0.23
North Africa	0.71	0.37	0.58	0.17	0.31	0.18	0.35	0.53
Sub-Saharan Africa	0.79	0.20	0.53	0.26	0.17	0.30	0.19	0.29
America	0.75	0.30	0.28	0.20	0.27	0.53	0.18	0.44
Asia	0.68	0.18	0.40	0.11	0.15	0.23	0.24	0.40
Memo Item:								
HIPCs	0.78	0.32	0.58	0.23	0.13	0.27	0.18	0.25

Source: UNCTAD secretariat computations based on OECD online statistical database

Note:

\*Aid includes net official development assistance (ODA) and other official flows (OOF).

Volatility is measured by the coefficient of variation of net ODA & OOF.

top 10 destinations of FDI in Africa received more than three-quarters of all FDI in Africa between 1999 and 2003 (UNCTAD, 2005a, table 2). The situation in Asia is similar to that in Africa: the top 10 recipients took 35 per cent of all aid to the region between 1960 and 1999, and attracted more than 90 per cent of all FDI in the region during 1999–2003.<sup>10</sup>

Table 5

SHARE OF TEN LARGEST AND TEN SMALLEST RECIPIENTS IN TOTAL AID TO AFRICA  
(Million US dollars)

	Period average: 1985-1994		Period average: 1995-2004	
	Value	Ranked by average of period	Value	Ranked by average of period
Ten Largest recipients	7865	Tanzania, Ethiopia, Mozambique, Nigeria, Sudan, Côte d'Ivoire, Kenya, Dem. Rep. of the Congo, Senegal, Zambia	8185	Mozambique, Tanzania, Dem. Rep. of the Congo, Ethiopia, Uganda, Zambia, Ghana, Senegal, Madagascar, Côte d'Ivoire
Ten smallest	555	Liberia, Gambia, Namibia, Mauritius, Comoros, Equatorial Guinea, Sao Tome & Principe, Swaziland, Seychelles, Eriteria	402	Lesotho, Gabon, Botswana, Gambia, Swaziland, Sao Tome & Principe, Comoros, Equatorial Guinea, Mauritius, Seychelles
Africa	22552	.	21061	.
Ten largest as per cent of total	34.9	.	38.9	.
Ten smallest as per cent of total	2.5	.	1.9	.

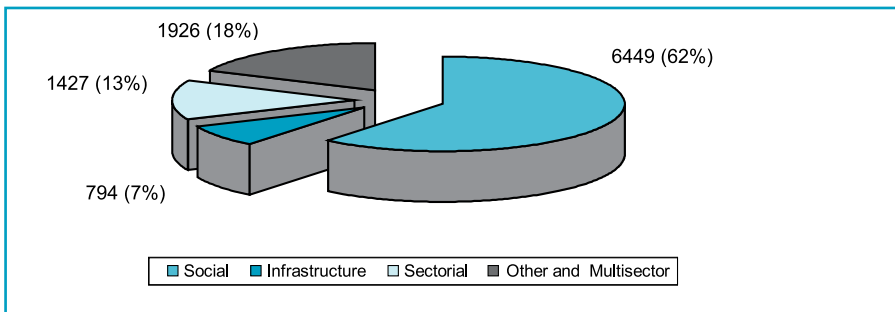
Source: As for Table 4.

*Aid is increasingly going to social sectors...*

With the increased focus on achieving the MDGs, aid has shifted towards social concerns, such as health, education and water supply, and away from broader economic development and growth objectives, which received relatively more support during the 1960s and 1970s (figure 4). Of the 13 countries with available data, 65 per cent of all resources released by the enhanced HIPC debt relief were to be devoted to social services, with only 7 per cent on infrastructure (4 and 1 per cent on governance and structural reforms respectively). World Bank/IMF HIPC progress reports also indicate that over half of government revenues will be earmarked for social spending in future years (Killick, 2004: 9).<sup>11</sup> Inevitably, this change in the focus of aid raises the question of whether the underlying causes of poverty and low rates of economic growth are being addressed adequately by donors and recipients and, in particular, whether investment in productive capacities is being neglected. The risks of such neglect are likely to be increased when aid consists of spending on technical cooperation.

**Figure 4**

**DEVELOPING COUNTRIES: DISTRIBUTION OF TECHNICAL COOPERATION BY SECTOR, 1992–2004**  
ANNUAL AVERAGES  
(Millions of US dollars)



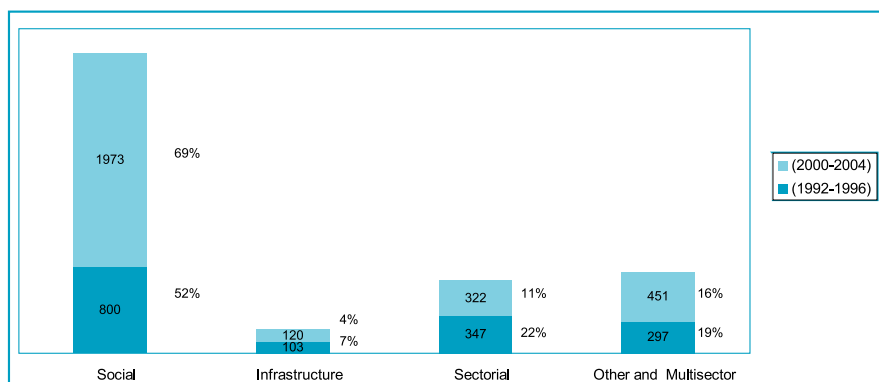
Source: UNCTAD secretariat computations based on OECD online statistical database.

Such spending in the social sectors of all developing countries has more than doubled from an average of \$4.0 billion in 1992–1996 to \$9.0 billion in 2000–2004. This represents an increase from 53 to 66 per cent of all technical assistance to developing countries, with corresponding falls in the shares going to economic infrastructure (8 to 6 per cent) and the productive sectors (20 to 17

per cent). In SSA, social spending as a proportion of technical cooperation rose from about 50 per cent in the first period to 70 per cent in the second, while the share of infrastructure fell from 7 to 4 per cent (Gupta et al., 2004: 14) (figure 5). This development is all the more worrying given that the share of technical cooperation in total ODA has increased considerably since the 1960s.

**Figure 5**

**SECTORAL DISTRIBUTION OF TECHNICAL COOPERATION IN SSA**  
(Period averages – million US dollars)



Source and notes: As for figure 4.

*.... and is still largely focused on projects*

Most aid to Africa goes to specific projects. At present, less than 20 per cent of bilateral aid to Africa is allocated to budget support, although it can be as high as 40 per cent for individual countries (Lawson et al., 2005). Only 26 per cent of total aid to 14 African countries went to budget support in 2004, increasing slightly to 28 per cent in 2005 (World Bank, 2006: 81). The “mutual review” jointly conducted by OECD/DAC and the Economic Commission for Africa (ECA) concluded, *inter alia*, that while programmes for broad sectors are increasing in number, aid remains predominantly focused on projects, and that in general they are poorly coordinated both in relation to each other and to broader, national development goals (Liebenthal and Wangwe, 2006).

*.... leading some observers to complain of “phantom aid”<sup>12</sup>*

The heterogeneity of aid has always made it difficult to assess its overall impact. Nevertheless, the diversion of aid to non-development or non-poverty-reducing objectives in recent years, estimated by one NGO at about 60 per cent of the total in 2003, has been blamed for the apparent ineffectiveness of aid in much of the developing world (ActionAid, 2005). Technical cooperation, which is both expensive<sup>13</sup> and supply-driven,<sup>14</sup> accounted for about one-fifth of all aid to Africa up to the end of the 1990s, showing only a marginal decline during the early 2000s. Emergency and distress relief, and debt forgiveness, increased to 7 and 13 per cent respectively of total aid to Africa during 2000–2004<sup>15</sup> (table 6).

**Table 6**

**AFRICA: NET OFFICIAL FLOWS FROM ALL DONORS BY TYPE OF FLOW,  
1960–2004**  
(Million US dollars)

	Average				Average: Share by components (%)				Volatility index			
	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	1960-1980-1990-2000-	
	2004	1989	1999	2004	2004	1989	1999	2004	2004	1989	1999	2004
Official Development Assistance	14268	16268	26158	28776	100.0	100.0	100.0	100.0	0.77	0.20	0.15	0.21
Bilateral grants and grant-like flows, of which:	8878	8917	16938	19505	62.2	54.8	64.8	67.8	0.82	0.27	0.13	0.28
Technical co-operation	2932	3646	5393	5160	20.5	22.4	20.6	17.9	0.72	0.22	0.10	0.10
Developmental food aid <sup>(a)</sup>	790	1146	736	491	5.5	7.0	2.8	1.7	0.47	0.16	0.53	0.09
Emergency & distress relief <sup>(a)</sup>	1046	..	493	1930	7.3	..	1.9	6.7	0.96	..	0.79	0.55
Debt forgiveness (grants)	2143	136	1682	3868	15.0	0.8	6.4	13.4	0.82	0.85	0.45	0.53
Bilateral Loans	2631	4082	4415	2455	18.4	25.1	16.9	8.5	0.71	0.18	0.30	0.23
Imputed Multilateral Loans	3879	3270	4805	6816	27.2	20.1	18.4	23.7	0.52	0.31	0.20	0.15

Source: As for Table 4.

(a) Emergency food aid is included with developmental food aid up to and including 1995.

Note: Technical co-operation comprises both free-standing and investment-related:

Developmental food aid: 1975-2004

Emergency & distress relief: 1992-2004

Debt forgiveness (grants): 1988-2004

Imputed multilateral flows: 1973-2004, i.e. making allowance for contributions through multilateral organisations, calculated using the geographical distribution of multilateral disbursements for the year of reference.

There are also concerns that geo-political considerations, despite the ending of the Cold War, are as influential as ever (AFD, 2005; Eurodad, 2006). According to one study, of the \$6 billion increase in official assistance between 2001 and 2002, \$3 billion was accounted for by debt relief, \$1 billion went to Iraq and Afghanistan, and about one-third (\$2 billion) went to other developing countries. Moreover, while official flows increased by \$10.5 billion between 2002 and 2005, about four-fifths (\$8 billion) of the increase were absorbed by

the depreciation of the dollar, and \$2 billion went to Iraq. Thus, in all, only \$500 million of the increase in aid between 2002 and 2005 catered to the needs of other developing countries (AFD, 2005: 23, footnote 37). The UNCTAD secretariat's own calculations suggest that the share of the top 10 recipients of aid in Asia doubled since 2000 because of large increases to countries such as Afghanistan, Iraq, Pakistan and Turkey, where geo-political concerns played a major role.

### 3. Africa's aid requirements

The need to increase concessional resource flows to Africa derives in principle from a consensus that the continent lacks sufficient domestic resources to attain an annual growth rate of 8 per cent, which most analysts consider to be the minimum required to achieve the MDGs. There is less unanimity, however, on the amount of aid required to bridge the resource gap in order to attain this rate of growth, the disagreements partly reflecting the difficulties of estimating the costs of meeting the MDGs in general.<sup>16</sup> The Zedillo report (Zedillo et al., 2001) estimates that roughly \$50 billion a year in additional ODA will be required to achieve the MDGs in all developing countries, although it emphasizes that a more accurate and comprehensive estimate would need to be based on individual country estimates. Devarajan et al. (2002) take two different approaches,<sup>17</sup> both of which yield estimates of the additional aid required at between \$40 and \$60 billion per year. These estimates, however, exclude certain costs, notably those of the complementary infrastructure required to support such rates of growth and investment.

Estimates of Africa's additional resource needs are similarly affected by the same difficulties and uncertainties, with different institutions producing a wide variety of estimates.

The NEPAD framework document, for example, suggests that Africa will need to fill an annual resource gap of \$64 billion (equivalent to 12 per cent of GDP) and acknowledges that, despite a significant increase in domestic resources, most of the increase will have to come from abroad (Funke and Nsouli, 2003:16). The projections of the CFA for low-income countries in Africa, which allow for the constraints on absorptive capacity, are for an additional \$37.5 billion per annum in public expenditures until 2010. One-third of this would come from domestic

resources and \$25 billion from aid (CFA, 2005). The G8, in their Gleneagles Declaration, call for aid to Africa to be raised to \$25 billion a year by 2010. In their conservative estimate of the additional ODA that Africa could use effectively for the improvement of infrastructure and human development, the World Bank and IMF argue for \$14–\$18 billion per year during 2006–2008, rising to \$24–\$28 billion by 2015 (Gupta, Powell and Yang, 2006: 1).

It is difficult to say with any degree of certainty how much additional assistance Africa will need by 2015, as this depends *inter alia* on the specific assumptions made regarding infrastructure needs, the efforts to increase domestic resource mobilization, and the current state of absorptive capacity. Nevertheless, on the basis of existing estimates, it would appear that, at minimum, Africa’s additional aid requirements are likely to be around \$20 billion per annum by 2008–2010, and increasing to about \$25 billion per annum by 2015.

## C. The “big push” revisited

In 1961, when the United Nations embarked on its first Development Decade, it was understood, by rich and poor countries alike, that there would have to be an intensified effort to mobilize internal and external resources if the designated growth targets were to be met. The underlying analytical framework, as noted in the last section, was centered on potential macroeconomic constraints to raising the level of fixed investment which was seen as crucial for faster economic growth. Given the prevailing estimates of the relation between increased investment and higher output, even a modest target of 5 per cent growth implied a sharp rise in the rate of capital accumulation in many countries if development was to become self-sustaining.<sup>18</sup> The most pressing constraint was generally seen to be the low level of domestic savings, but the large import requirements of an investment surge also raised the likelihood of a foreign exchange constraint emerging as growth accelerated. Exports, by providing a “vent” for surplus production, were seen as one way of breaking these constraints on growth, bringing additional resources, including much-needed foreign exchange. Successful exporting, however, particularly of more dynamic products, was dependent on strong investment, and post-war trends in international trade, as outlined at the first UNCTAD conference in 1964, were anyway not encouraging for many poorer countries. The response was a double-pronged reform agenda consisting of proposals to rebalance the trading system in favour of developing countries and

to increase foreign aid in support of productive investment. The ODA target of 0.7 per cent of the GNI of the developed countries emerged during the debates in the late 1960s on a Second Development Decade.<sup>19</sup>

Because the logic of a “big push” was closely tied to the idea of an industrial take-off, it was generally assumed that economic development could not be left entirely to market forces. Long gestation periods, strong complementarities, scale economies and technological externalities in the industrial sector were seen as key features of a dynamic growth path, at the same time as they pointed to potential coordination failures and implied a minimum level of investment if a process of cumulative growth was to get under way. Success would lead to rising domestic savings, fiscal revenues and increased private capital inflows that would eventually supplant official aid. In essence, this implied a conception of the development process where the social returns to investment diverged from private returns, where the profit maximization principle of individual firms, acting alone, would not generate a sufficient rate of capital accumulation to escape a low-level income trap, where some degree of stimulation and coordination by the state would be needed, and where aid was expected to play a catalytic role.<sup>20</sup>

This approach did not meet with universal agreement; in particular, a number of high profile studies argued that crowding out and waste were the more likely outcomes of increased aid.<sup>21</sup> There was also criticism of the implied bias towards industrial development and the neglect of agriculture, which was seen as weakening export performance. Moreover, the pattern of industrialization raised concerns about capital-intensive techniques, giving rise to high rates of urban unemployment and growing inequality.<sup>22</sup>

While these early aid debates were set against a generally stagnant level of aid flows and were hampered by missing or unreliable data, a multitude of studies have since examined the effectiveness of aid, drawing on a large sample of countries and over long time periods. Most of these studies use econometric techniques to analyze both cross-sectional and panel data on economic growth and aid commitments or disbursements in order to explore the relation between them. The aid sceptics have continued to dominate the aide literature. One reading of the evidence contrasts the micro-level effectiveness of aid in terms of meeting welfare goals and achieving acceptable economic returns with its macro-level ineffectiveness in terms of overall economic growth (Mosley et al., 1987). On the latter, the argument has increasingly turned to the contingent



nature of the link between aid and growth, be it focused on getting policies right (openness) or location right (outside the tropics) or competitiveness right (Burnside and Dollar, 2000; Roodman, 2004; Rajan and Subramanian, 2005). For others, who see the divide less in terms of a micro-macro split and more in terms of isolated success stories amid generalized failure, emphasis has been placed on getting institutions right so as to avoid a culture of aid dependency (World Bank, 1998; Azam et al., 1999).

However, such scepticism rests on inconclusive evidence. In a recent survey of some 64 cross-country regressions on the link between aid and growth, 38 had a significant and positive relation, 25 were insignificant and in only one was the relation significantly negative (Hansen and Tarp, 2000). Moreover, aid seems to work in a range of different environments and its positive impact on growth, as will be discussed further below, is difficult to tie down to “good policies”, at least as narrowly defined. There is also plenty of evidence suggesting that ODA still has advantages over private capital flows, including FDI, in poorer countries, not least because private investors usually wait for growth to take off before moving into an emerging market economy.<sup>23</sup>

Drawing useful policy conclusions from the empirical literature on aid effectiveness is complicated by the methodological pitfalls of cross-country regression equations, described by one reviewer as “an anarchy of numbers” (Roodman, 2004). One of the principal problems is endogeneity: aid may influence growth but it is also possible that the amount of aid received by a country in any given year is influenced by its present or expected growth rates. There are at least two plausible ways of dealing with this problem. The first is to use instrumental variables to isolate the independent influence of aid and to measure its impact on growth. Geo-political factors, which are usually extraneous to the economic performance of a recipient country, provide one set of measures. An alternative is to examine the effectiveness of aid over a sufficiently long period to rule out any plausible conditioning of aid received on expectations of future growth. Another problem is that extreme observations (outliers) often have a strong bearing on the results, deflecting attention from what is happening in the majority of countries in the sample and distorting policy conclusions. To take one prominent example, the conclusion of Burnside and Dollar that a positive impact of aid on growth is contingent on good policies hinges on just seven outliers whose removal from the cross-country regressions used to substantiate this conclusion actually reverses the finding (Roodman, 2004: 36).

Behind the latest round of debates about the effectiveness of aid is a recognition that aid is a good deal more multifunctional and fungible than was presumed in the early debates, and that consequently its impact on growth is unlikely to be reflected in the simple linear relationships which marked the earlier analysis. With this in mind, Hansen and Tarp (1999) have introduced unobserved country-specific effects, conditional convergence, and the endogeneity of aid and policies into their cross-country analysis: they nevertheless still find a positive and significant impact of aid on growth for a sample of 56 countries over the period 1973–1993. Along with other studies, they also find that this impact weakens beyond a certain level of aid (section D.1(b)). A more recent study by Clemens et al. (2004) draws a more favourable conclusion by disaggregating aid into “short impact aid”, associated with budget support and project aid for the real sector, “long-impact aid”, associated with technical cooperation and investment in the social sector, and humanitarian aid. They find a strong, positive, causal relationship between short-impact aid and economic growth, a relation that holds independently of the institutions and policies in place. According to their estimates, aid may have raised the growth in GDP per capita in SSA by as much as half a percentage point between 1973 and 2001. There are plenty of country-level experiences, including in Africa, which seem to confirm this conclusion; it is plausible to link the recent sustained high growth rates in Mozambique, Uganda and United Republic of Tanzania, for example, to the infrastructure and balance of payments support provided by high levels of aid per capita (UNDP, 2005: 81).

That said, longer-term growth effects, which should ultimately decide the value of development aid, are a good deal more difficult to detect, particularly on the basis of cross-country regression equations. One possible channel for a positive effect is through the influence of aid in accelerating (or inhibiting) structural change in an economy. In this respect, sceptics have long warned of an “aid curse” associated with the Dutch Disease. The evidence for this (as discussed in section D.1(a)), however, is inconclusive.

A recent study by Reddy and Minoiu (2006) separated aid into its different components in order to assess their individual long-term impact on growth in the recipient countries using a standard cross-country growth model. With average per capita income growth in the 1990s as the dependent variable, the relevant explanatory variables are averaged and the regression equations estimated for four

different time periods: 1960–2000, 1970–2000, 1980–2000 and 1990–2000. The result was that the lagged aid variable was a significant factor explaining growth in the 1990s: an increase in aid during the earlier periods by one per cent of GDP raised the average growth rate of GDP per head by as much as 0.01 percentage points in the 1990s.

The same study also tried to isolate the components of total aid that were truly growth-enhancing. Three proxies for development aid were used: (1) multilateral aid; (2) bilateral aid from the Nordic countries (including Iceland) and (3) bilateral aid from a larger group of developmentally-minded donor countries (the Nordics plus Austria, Canada, Luxembourg, the Netherlands and Switzerland). The basic reasons for making these distinctions are that multilateral aid is more firmly geared to developmental than to geo-political aims and that some donor countries are more developmentally-minded than others. While this approach is not without its limitations, a recent study of Nordic aid found clear differences from other bilateral donors in terms of its generosity, its bias towards democracies, in being less conditional on openness criteria but more conditional on the human rights record, and in not depending on the "friendship" of the recipient (Gates and Hoeffler, 2004). These donors traditionally tie a much smaller percentage of their aid to purchases of services and goods in their own countries (UNDP, 2005: 102).

The results of this disaggregation are quite striking. An increase of 1 per cent of GDP in multilateral aid in the 1960s is associated with an increase of half of a percentage point in the average growth rate of per capita GDP in the receiving countries in the 1990s, and a similar increase in aid in the 1970s added a quarter percentage point to the growth rate two decades later. At the same time geo-political aid has a negative and statistically significant impact on growth (Reddy and Minoiu, 2006, table 5(a)).<sup>24</sup> One qualification to these specifications is that some bilateral aid may be developmental in nature but has been omitted from the proxy for development aid in the regressions. The results of separately identifying aid from the two donor groups are notable: average growth between 1980 and 2000 was raised by over one percentage point in those countries receiving an additional one per cent of GDP in aid from the Nordic countries in the 1970s and 1980s, a result that was relatively robust to alternative specifications of the relationship.

Evidence about the positive long-term effects of aid on growth is important given the renewed commitments being made by the donor countries.

Nevertheless, it has generally been a secondary factor in explaining economic growth, and its impact has clearly been insufficient in many cases to counteract other unfavourable influences. In the case of Africa, various studies have shown that since the early 1980s aid has barely compensated for losses resulting from the decline in the terms of trade, let alone meeting the resource needs for rapid and sustained growth.<sup>25</sup>

Recognizing this underscores the importance of identifying the possible channels through which aid can be more effective. A growing body of evidence suggests that the aid-investment nexus remains key to unlocking sustainable growth. Hansen and Tarp (1999) found that 15 of 16 studies examining this nexus report a positive connection, with only one showing evidence of crowding-out. Their own cross-country regressions for 56 countries between the mid-1970s and early 1990s confirm a significant and positive impact of aid on fixed investment (Hansen and Tarp 2001). A more recent study of 25 SSA economies over the period 1970–1997 found strong evidence of an aid-investment-growth nexus (Gomanee et al., 2005).

These findings, while cognizant of the challenges of aid absorption (discussed in more detail in section D.1), nevertheless provide a good deal of encouragement to those calling for a renewed attempt to support a “big push” for development with significant amounts of aid. The UNCTAD secretariat was among the first to revive this approach in the context of African development. While noting that country level factors have a major bearing on financing needs, it estimated that sustaining a 6 per cent growth rate would need an investment rate of between 20 and 30 per cent of GDP. Even in those parts of the continent where savings were relatively strong in the 1970s, this would require a doubling or tripling of aid, depending on the investment target, over a 10-year period (UNCTAD, 2000a: 22–31). In all the scenarios examined, official inflows as a share of GDP would eventually begin to decline as domestic resources and foreign private capital flows responded to strong growth.

This kind of aid dynamic has been clearly present in a number of success stories beginning with the newly-industrializing economies of East Asia, but including Botswana from the late 1960s, Ireland from the early 1970s and Costa Rica in the 1980s (box 2). A prominent feature of all these successes (with the exception of Botswana) is the way in which aid proved to be a catalyst for dynamic, industrial growth. In numerous studies, UNCTAD has linked such a dynamic to the pace and pattern of capital formation, including the exploitation

of natural resources through diversification and increased processing of resource-based products. The key factors are the link between profits and investment, and the possibility that a low profit rate (due to a small capital stock in the industrial sector) prevents capital accumulation from taking off.<sup>26</sup> In the light of East Asian experiences, there has been a revival of interest among academic economists in the logic of the “big push”. In a seminal paper, Murphy et al. (1989) linked the efficiency of the industrial sector to the size of the domestic market through various pecuniary economies and profit spillovers whereby industrialization in one sector raises demand for other manufactures, making large-scale production more attractive, or where industrialization in one sector creates a demand for its output, thereby triggering market expansion.<sup>27</sup>

### Box 2

#### “BIG PUSHES”

A principal aim of development assistance is to contribute to a process of rapid and self-sustained growth. Trying to pick out success stories from cross-country econometric studies faces a string of methodological obstacles (Rodriguez, 2006) and a more historical perspective therefore seems better suited to identifying the interactions between large aid flows and the non-linear and discontinuous components of a successful development process. From this perspective, a number of big push stories propelled by aid can be identified and which have succeeded in generating sustained growth by mobilizing domestic resources and foreign, private capital. The East Asian newly-industrialized countries, notably Republic of Korea and Taiwan Province of China, were early examples of a successful big push. In the former, aid rose sharply from the early 1950s peaking in 1957 at close to \$400 million before dropping sharply in the early 1960s and descending more gently thereafter. As a share of GDP, aid peaked in the late 1950s at some 20 per cent of GDP, allowing investment to exceed domestic savings by some 7 percentage points and covering close to 90 per cent of the import bill. These figures began to fall sharply in the 1970s thanks to sustained economic growth, before fading out in the 1980s. The full significance of aid can be gauged by the fact that the nearly \$6 billion in US economic aid to South Korea between 1946 and 1978 was only marginally lower than its total aid (\$6.89 billion) to all of Africa in the same period. A similar pattern can be found in Taiwan Province of China, where aid peaked in the mid-1950s, reaching \$190 per capita for the period 1953–1957 (two-thirds of which came through the military assistance programme). Although Taiwan Province of China began its big push on the back of a greater degree of domestic resource mobilization, aid still accounted for nearly 40 per cent of gross domestic capital formation in the 1950s. Again, the role of aid dropped off as growth picked up sharply in the 1960s and the savings-investment gap closed with rising domestic incomes. Still, total aid to Taiwan Province of China

**Box 2 (contd.)**

between 1949 and 1967 was over \$4 billion and per capita was higher than that to Korea and dwarfed that to Africa.<sup>a</sup>

In Africa, aid has also played a catalytic role in two of the continent's much heralded success stories, Botswana and Mauritius. The former had a very high aid to GDP ratio at the time of independence, but while aid continued to rise through the 1980s, peaking at \$120 per capita in 1987, the ratio dropped sharply thanks to a sustained period of rapid growth. A similar picture can be found in Mauritius where aid peaked at over \$80 per capita in 1990. In both cases, relatively strong state structures were able to resist capture by political elites, to design and implement more encompassing development plans, and to mobilize domestic resources. FDI played a more prominent role in sustaining their growth than in East Asia, albeit a number of years after their take-off to sustained growth. However, in both countries, rising volumes of FDI have failed to stimulate the kind of diversification of economic activity seen in East Asia. A number of middle-income, "big push" stories have been more successful in attracting FDI into a dynamic growth process following a period of aid-driven infrastructure development. This was the case in Ireland, which enjoyed huge inflows of aid from the EU for almost two decades before FDI entered on a significant scale into high-tech sectors. Aid per capita to Ireland has been estimated at around 340 euros per year since it joined the EU, reaching a peak of 750 euros in 1997. A similar pattern, albeit not on the same scale, can be seen in Costa Rica which received large amounts of aid in the 1980s, peaking at over \$100 per capita in 1985, prior to attracting FDI in the 1990s.<sup>b</sup>

- a For accounts of the role of aid in these countries, see CBO (1997), Jacoby (1967) and Hong (1997).
- b As discussed in Hanson 2001 and UNCTAD 2002, there are some questions and doubts about the development impact of FDI in the context of international production networks, as was the case in Costa Rica.

It would be wrong, however, to extend a big-push logic to Africa in terms of a simple repetition of these experiences. There are similarities but also significant differences in the initial conditions (particularly in the rural economy) found in African countries today and those in East Asia in the 1950s and 1960s. Moreover, the fact that African development has suffered a quarter of a century of stagnation and regression, most notably with respect to structural change and the steady informalization of economic activity, also cautions against any simple notion of replication. Perhaps with this in mind, Sachs et al. (2004) have suggested that the MDGs provide a set of appropriate investment targets that can help to break Africa's "poverty trap".<sup>28</sup> Using a more recent vintage of growth model, their argument assumes that the existing capital stock in most African economies

remains below the threshold level necessary for take-off due to the mutually reinforcing effects of weak capital accumulation, low savings and population growth. Their analysis identifies a series of specific constraints that make SSA particularly vulnerable to a persistent poverty trap: these include very high transport costs and small market size, low-productivity agriculture, a very high burden of disease, adverse geo-politics and a very slow diffusion of technology from abroad.

Against such a background, the basic aim of development strategy is again seen as reaching the threshold where the combined impact of scale economies, complementarities in production, and linkage effects can generate a self-sustaining process of pro-poor growth with private investment taking over the lead. According to their estimates, a large, well-targeted infusion of aid, focused particularly on public infrastructure in transportation, irrigation and power to help raise rural productivity, but including support for rural household investment to raise productivity in the small-scale farming sector, could do the trick in many African countries (Sachs et al., 2004: 151–155). This kind of pro-poor, investment strategy finds support in the complementary literature on building inter-sectoral linkages between the rural and urban economies. Indeed, there appears to be plenty of evidence that strong productivity growth in the agricultural sector can spill over to the rest of the economy through cheaper inputs for industry, cheaper food for industrial workers, expanding markets for industrial output and increased foreign exchange earnings from greater exports.<sup>29</sup>

Finally, the CFA Report has argued forcefully for a frontloading of aid to Africa on the grounds that the returns to large-scale investment are likely to be higher now rather than later and higher still if aid is integrated in a coherent package of measures rather than being disbursed in a piecemeal fashion. It concludes that: “a critical mass of sensibly invested interventions financed by frontloaded aid will improve social conditions and accelerate growth. Over time, the latter will in turn generate the domestic resources required to finance development, and this should eventually reduce the need for more aid”. In their proposal of where the sectoral priorities might lie, the focus is very much on human capital development, with a particularly strong emphasis on health (including treatment of HIV) and education. The case for such an emphasis rests essentially on potential spillovers from social capital to productive capital, but also on a strengthening of the institutional framework for designing and implementing policy.<sup>30</sup>

While these recent interpretations of a big push strategy point to differences in policy emphasis, all recognize that minimum levels of governance must be in place for it to work.<sup>31</sup> The suggestion, made implicitly or explicitly by those advocating a big push, that most countries in Africa have made significant improvements in economic and political governance in recent years, has not met with universal agreement. Some of the criticism, as noted earlier, does little more than repeat the “government failure” arguments of the 1970s. More serious questions have been raised, however, about whether the “growth-enhancing governance capabilities” needed by developing countries to manage domestically or externally generated productive assets and resources (in such a way that cumulative income and productivity gains are assured) can be found in the potential recipients of aid (Kahn, 2006). The steady erosion of state capacities under SAPs (as discussed in the next section) and the brain drain afflicting many African countries point to low pay and low morale, as much as lack of technical competence, as the main problems with many African civil services.<sup>32</sup> Various commentators have also warned donors against the “fatal conceit” of assuming they already know enough to mount an ambitious drive to eradicate global poverty in the absence of domestic institutions that, through trial and error, are crucial for discovering what really works at the local level.<sup>33</sup>

What is known, and with at least some degree of certainty, is that the recent tendency to add more and more conditionalities (including those aiming to get institutions right) to aid and official lending has in most cases been counterproductive, and is a further warning against a heavy-handed, top-down approach (UNCTAD, 2002). Nevertheless, there are lessons from earlier success stories that suggest a major investment push can take place simultaneously with institutional learning to establish a rapid and sustainable growth trajectory. In particular, the strengthening of state capacities that this undoubtedly implies will in many cases occur as growth picks up and structural transformation proceeds. Aid can be used to help strengthen these capacities, not least in areas such as the management of public finance; indeed, it is clearly recognized in both the Sachs and CFA reports that aid can be usefully directed at strengthening the capacities of policy makers through technical assistance and training to ensure effective design, monitoring and evaluation mechanisms. At the same time, efforts from outside aimed at strengthening such capacities need to ensure the right balance with local ownership of any plans.

What is also important is that African policy makers have room to learn from past mistakes. This will include finding a larger (albeit measured) role for



market forces than was allowed under many post-colonial policy regimes, but it will also take on board the policy mistakes that have accompanied the one-size-fits-all package of liberalization, stabilization and privatization measures that have accompanied adjustment programmes. It will also imply introducing greater transparency into budgetary processes along with improved monitoring and supervision, including a greater role for open discussion with stakeholders and parliamentary bodies. In this respect, after 25 years of tying aid to structural adjustment policies, there is a growing recognition that increased aid is likely to provide a permanent exit from poverty for many countries only if there is a shift towards development oriented pro-growth policies and if countries are given more room to experiment with different measures to overcome the particular constraints they face in mobilizing their own resources.

Contrary to much conventional wisdom, the weight of evidence seems to suggest that aid can work to stimulate growth. It can only do so, however, when provided on an appropriate scale and when focused on the right targets. Failures in both respects over the past two decades have meant that it provided little counterweight to various growth-reducing tendencies. As a rule of thumb, both the quantity and the quality of investment matters to long-term growth, and getting investment right cannot be assumed to follow automatically from getting prices right. In this section it has been suggested that in the case of Africa, this will almost certainly mean a renewed focus on sectoral aid, to both industry and agriculture, on infrastructure development and on strengthening human capital. Moreover, there are likely to be strong complementarities between all of these. It has also been suggested that getting the balance right cannot be determined *a priori*. Indeed, different countries face different constraints on their prospects and the targeting of aid to break those constraints will require detailed knowledge of local conditions. Putting these ideas about the effectiveness of aid into practice, however, also depends on the institutional architecture for raising and organizing it. This will be discussed in the final section of this report but first a number of the key issues need to be discussed.

## D. Putting aid to work: some key issues

Although there is now a clear commitment to double aid to Africa, it is recognized, by donors and recipients alike, that much work remains to be done to organize it in such a way as to maximize its impact. Simply doubling

aid, especially to SSA, will not automatically secure the MDGs, let alone wider development objectives. Indeed, aid sceptics have been quick to argue that despite aid to SSA totalling \$390 billion between 1980 and 2004, its generally weak economic performance, with per capita income falling 0.2 per cent annually over the same period, shows that aid does not work. Such simple accounting exercises, however, are no substitute for careful economic analysis of the impact of aid. There is no doubt that the “quality” of aid is as important as its “quantity” and that poorly delivered or poorly utilized aid can be just as damaging as too little aid.<sup>34</sup>

Even accepting that there is no automatic link between increasing aid and achieving economic and social goals, and that there are potentially negative effects, it still makes little sense to simply accept the sceptics’ arguments against a doubling of aid to Africa. A more constructive approach is to ask why it might have underperformed in the past and to explore how effectiveness might be improved as aid is increased over the coming decade. This is a challenge with both institutional and policy dimensions, and it touches on the behaviour and responsibilities of both recipients and donors. These, as will quickly become apparent, are closely connected.

The institutional challenge can be divided into two broad sets of issues: absorptive capacities (on the recipient side) and aid modalities (on the donor side). Problems with both have been cited to suggest why African countries might find it difficult to use increased aid effectively to trigger self-sustaining growth across the continent, and to do so in a manner compatible with meeting the MDGs. The purpose of this section is not to provide definitive solutions to all the possible problems that might arise with a doubling of aid, but to highlight some of the most pressing and persistent institutional issues on which more thought and research will be needed if aid is to become history for the right reasons, namely because it has successfully led to self-sustaining growth and development.

## 1. Absorptive capacities

It is clear that development aid can never be a lasting substitute for the mobilization of domestic resources. Instead, the objective, broadly conceived, is to break some of the economic and social constraints on such mobilization and to bridge some of the gaps that might otherwise hinder or undermine the process. Nevertheless, it seems likely that the nature of those same gaps and

constraints will also have a bearing on how effectively a recipient country is able to use the extra resources provided through aid. This presents countries with something of a dilemma, however, since the recipient’s capacity to absorb aid depends in part, sometimes considerably, on the removal of supply constraints as well as various institutional constraints (especially of human capital and skills) for which the help of aid was needed in the first place.

An important requirement of efforts to deal with this conundrum is for the recipient country to have a coherent programme for tackling the various constraints and, especially important, to agree with donors on a realistic timetable for doing so. A crucial ingredient of policy success in all domains is to judge correctly how much time is needed to bring it to fruition. This serves to emphasize that one of the primary functions of all aid is to give governments time, to provide them with sufficient “breathing space” to tackle serious structural problems without imposing excessive social and economic costs on the local population.

### (a) Supply constraints and distorted incentives

Aid allows recipients to increase consumption and investment. If, as is generally the case, spending is not equal to absorption, the economic impact of additional aid will depend on macroeconomic policy responses (Gupta, Powell and Yang, 2006).<sup>35</sup> Depending on just how much of the aid is absorbed by the Central Bank (i.e. how much of the foreign exchange generated by aid it decides to sell) and spent by the government (i.e. the size of the aid-financed fiscal deficit), there is certainly a potential for increased inflationary pressure. If the nominal exchange rate is not automatically adjusted to compensate for this (as under a *de facto* fixed exchange regime), the real exchange rate will appreciate, thereby undermining the competitiveness of a country’s exports and lowering the domestic price of its imports. Such an outcome, often referred to as the “Dutch Disease”, raises the possibility that the additional resources from aid could be more than offset by a decline in the mobilization of local resources, thereby perpetuating aid dependence.<sup>36</sup> This assumes that the aid recipient is principally supply rather than demand constrained, which is not implausible. However, a number of additional factors will have a bearing on the outcome,

including: the extent of underutilized capacity and the ease with which it can be employed; the degree of exchange rate flexibility; and the opportunities for rapid trade liberalization. Moreover, if the authorities sterilize the inflow of foreign currency, by selling government securities or central bank bonds in a manner that does not increase domestic demand, the problem may be avoided. This strategy, however, is tantamount to using aid simply to increase a country's foreign exchange reserves rather than to provide additional purchasing power over real resources (box 3).

### **Box 3**

#### MANAGING WITH AID

It has been estimated that in the 1990s less than two-thirds of the capital inflow to Africa was actually used to acquire real resources via financing of the current account deficit. Given that much of the net inflow was ODA, this implies that a significant proportion of aid was diverted from the acquisition of resources, thus reducing its impact on investment and growth (UNCTAD, 2000a). This trend, according to a more recent International Labour Organization study, has continued into the new millennium: reserve holdings in SSA as a percentage of GNI have risen from around 5 per cent in the early 1990s to around 12 per cent a decade later (van der Hoeven and Lubker, 2006). If this persists, there is a real danger that it will undermine the effectiveness of the doubling of aid to Africa as a means of stimulating the investment-growth nexus.

There are, of course, a number of plausible reasons for using aid to boost reserves, whether to ensure that a foreign exchange constraint does not emerge to block the acquisition of imports necessary for growth, as a prudent response to the volatility and unpredictability of future flows of aid, in anticipation of other macroeconomic shocks, or as a part of a strategy to preserve a competitive exchange rate. The data suggests, however, that the recent build up of reserves in Africa is well in excess of anything required to cover import needs.

It would seem, therefore, that part of the increase reflects a defensive move to guard against speculative attacks on the currency and capital flight. Indeed, the two ways in which aid has been diverted away from real resource acquisition are closely related: capital flight increases the likelihood of a currency depreciation and speculative attack and therefore necessitates a higher level of reserves to guard against this, in other words, the greater the capital flight the greater is the need for defensive reserves. The increased diversion of aid and other capital inflows to counter capital flight and accumulate reserves in Africa has coincided with the progressive liberalization of capital accounts in a number of countries in the region.<sup>a</sup> This raises the question as to whether increased aid should continue to be accompanied by the orthodox prescription of capital account liberalization.

**Box 3 (contd.)**

If aid is doubled and the capital account liberalized, it is likely that an increasing proportion of this aid, over and above the already high level, will simply be devoted to covering capital flight and accumulating reserves. Indeed, if Dutch Disease is also prevalent, currency management will become extremely difficult for countries receiving substantial aid and at the same time liberalizing their capital accounts. On the one hand the aid inflow is likely to lead to inflationary pressures and a real exchange rate appreciation that will require an offsetting nominal devaluation. If at the same time the capital account is open, the perception of an overvalued exchange rate is likely to lead to both capital flight and speculative attacks that will put further downward pressure on the currency. The upshot is likely to be massive currency depreciations or devaluations with all their attendant negative consequences. This constitutes a strong case against orthodox capital account liberalization.

The above scenario is worrying in the light of the finding that an overvalued exchange rate is a threat to growth in SSA (IMF, 2005) and the empirical evidence that suggests that a well-managed exchange rate is more appropriate for low-income countries than a floating regime (Harrigan, 2006). For low-income countries with a record of good fiscal policy, a fixed exchange rate regime may well deliver benefits in terms of both lower inflation and higher growth (Hussein et al., 2005). Based on the experience of Uganda, Tanzania and Mozambique in the 1990s, Buffie et al. (2004) have also suggested that a managed exchange rate is the preferred option for handling large aid inflows.

The choice of regime, of course, will depend on the set of multiple objectives that policy makers are seeking to achieve in a particular country at any given time (Ocampo, 2005). On most assessments, however, the exposure of low-income countries to volatile international capital movements is something to be avoided. The implication is that capital account liberalization in tandem with large increases in aid will not permit the most desirable exchange rate regime to be adopted in low-income, African countries. As a result, there is a real danger of a vicious circle developing: the more open the capital account the more likely it is that aid will be used to offset capital flight and increase reserves, and thus less aid will be available to acquire productive resources and hence alleviate domestic supply bottlenecks; this in turn increases the threat of inflation and of an overvalued exchange rate leading to the likelihood of a speculative attack on the currency and hence the need for even larger reserves.

- a For example, Egypt, Kenya, Mauritius and Uganda moved to complete capital account liberalization by the end of the 1990s and in all except Kenya capital flight rose substantially compared with the 1980s. There is also evidence of substantial and volatile flows of capital, seeking arbitrage gains of the sort that contributed to the East Asian currency crisis of 1997, entering Kenya, Uganda and United Republic of Tanzania (Bhinda et al. 1999). For a discussion of capital account regimes in Africa, see Ndikumana (2003).

Increased aid flows can lead to Dutch Disease irrespective of the exchange rate regime, if not properly managed. However, the prevalence of the *de facto* fixed exchange rate regimes in Africa (24 of the 44 IMF reporting African countries) has led some observers to argue that as only a quarter of capital inflows into Africa in the 1990s was channelled into reserve accumulation (combined with the prevalence of weak and underdeveloped financial sectors), its occurrence would be more likely in these countries. The evidence that this has been a serious problem in the past is inconclusive. Rajan and Subramanian (2005), for example, drawing on a rather small sample of countries for the period 1980–2000, report “compelling evidence” of real exchange rate appreciation linked to inflows of aid (whether by raising the price of intermediate inputs or pushing up the nominal exchange rate) thereby squeezing the dynamic labour-intensive manufacturing sector which would normally be the engine of long-term growth in poorer countries. However, there are problems in attributing causality in their analysis. Their finding is strongest for the 1980s, although the impact of aid on the exchange rate appears weaker than in the 1990s. In fact, it seems more likely that the external shocks at the start of the 1980s, which undermined manufacturing capacity, particularly in the export sector, also triggered additional aid (including through adjustment lending). The IMF (2003: 21–22) has concluded that concerns about Dutch Disease should not be overstated, suggesting that a doubling of aid from 10 to 20 per cent of GDP would lead on average to a real appreciation of just 6 per cent, and even less if the aid is spent on increased imports.<sup>37</sup>

The appropriate response to the threat of Dutch Disease is clearly not to cut back on the promises of aid but to look at how the problem can best be dealt with without compromising broader development objectives. This is, in part, a matter of ensuring that governments have a broad view of macroeconomic stability along with sufficient policy space to manage external flows of all kinds (Ocampo, 2005). But any viable solution must obviously ensure that aid is used to help alleviate domestic supply bottlenecks so that any associated increase in demand does not lead to strong inflationary pressures. This essentially means using aid to finance “productivity-increasing investments” (IMF, 2003). But, given concerns about the foreign exchange gap as growth accelerates, aid must also be used in such a way that it produces additional foreign exchange earnings. These conclusions point to the need for development strategies in Africa to go beyond a focus on poverty reduction through boosting social welfare expenditure on health and education. Such expenditure, unlike that in the productive sectors

and on economic infrastructure, is unlikely, at least in the short and medium term, to alleviate supply bottlenecks or generate foreign exchange.

Aid may also introduce incentive problems, other than through inflationary and exchange rate pressures. The fact that donors' own budgetary procedures, which dictate the speed of disbursements, are often detached from agreed commitments, since donor development agencies (which make the commitments) are not the same institutions that approve them (parliaments) or control the budget and disburse them (Ministries of Finance), is a potential source of unpredictability in aid flows. Added to this is the fact that disbursements of aid tend to be persistently lower than commitments,<sup>38</sup> the outcome being a pattern of delivery which fails to synchronize with the recipient's budgetary cycle and fiscal requirements. Indeed, to the extent that they rise and fall with the economic cycles of donor countries, with changes in donor policies and with periodic assessments of policies in recipient countries, aid flows can, like private capital flows, provoke shocks and introduce volatility into the recipient's economy. "Aid shocks" (measured by the gap between commitments and disbursements) in the range of 4 per cent of GNI have been estimated for some African countries with particularly damaging consequences for some sectors in heavily aid-dependent countries (UNDP, 2005: 98). Such a pattern is unlikely to help offset the effects of external shocks, to which Africa is particularly vulnerable. If anything, there appears to be a positive correlation between aid and other macroeconomic variables such as fiscal and export revenues (UNCTAD, 2000). The complementarity of much bilateral aid with domestic currency resources of the recipient government introduces an additional pro-cyclical tendency in the aid delivery system; negative external shocks lead to the recipient government not being able to provide domestic counterpart financing and hence delaying the disbursement of aid. These problems are likely to be exacerbated if aid is influenced by herd behaviour among the donors leading to the concentration of flows in a few countries, but which are also vulnerable to shortfalls if perceptions suddenly change. This erratic and unpredictable nature of aid disbursements not only poses a threat to the stability of macroeconomic policy but can also be damaging to public investment planning, particularly in areas such as infrastructure, health and education, where long-term commitments are required.

Such problems arising from the multi-donor and uncoordinated nature of the aid delivery system have often been exaggerated by the operations of the international financial institutions. Programme aid, such as IMF and World Bank policy-based loans, which respond to current account and budget deficits, are

often pro-cyclical. For example, an adverse movement in the terms of trade can often undermine government revenue and budget performance; if this results in an IMF programme going off track, for example, a country may find bilateral donors suspending their budget support thereby worsening the crisis. The overall logic of the aid delivery system therefore runs the danger of exaggerating rather than countering the pro-cyclical behaviour induced by external shocks.

There is plenty of cross-country research confirming that aid is volatile and pro-cyclical,<sup>39</sup> and that situation does not seem to have improved in recent years, despite commitments and exhortations to reduce aid volatility by linking disbursements to governments' budgetary and fiscal cycles; volatility increased during the late 1990s and remained high in the early 2000s compared with the 1970s and 1980s. The upshot is that the changes in programme design and ownership, including in donor coordination stemming from, among other things, the PRSP process since 1999, have not reduced volatility. Indeed, it was greater during the post-PRSP period (2000–2003) compared with the pre-PRSP period (1995–1998) and it was much higher for several SSA countries, including Rwanda, Uganda and United Republic of Tanzania.

A longstanding argument of aid sceptics is that because of its “fungibility” aid can be misused in ways that have a directly negative impact on growth prospects and in the process distort the behaviour of economic actors by encouraging unproductive, rent-seeking activities. Put simply, if aid funds a school project that the recipient government would have funded anyway in the absence of the aid, this releases government resources to be spent on something else, e.g. presidential palaces or military hardware or bolstering the local political base, which is then effectively the true contribution made by aid. This is most damaging when funds are diverted to personal consumption or where political patronage is the overriding motive. The problem will be less if aid finances a new activity which the government could not have afforded or if the fiscal process of the country concerned is transparent and well prioritized in line with development objectives. Moreover, given that the government has more information about maximizing the benefits of aid than the donor, fungibility could in fact be growth enhancing. Certainly, if government is already spending on the right things the issue does not arise.<sup>40</sup>

All too often, however, complaints about fungibility are simply a cover for ascribing distorted outcomes to any form of state intervention in the workings of the market economy, particularly through rent-seeking behaviour.<sup>41</sup> Nevertheless,



it is important to ask how a surge in aid might undermine growth incentives through misguided state action. One obvious possibility is that aid might weaken the pressure for needed reform. This is akin to the “moral hazard problem” where recipients feel they can spend aid money without being subject to close scrutiny, confident that donors will continue to bail them out.<sup>42</sup> The problem has often been linked to Cold War geo-politics. The logic has been extended to the “weakly accountable nature of many African political systems” (Killick, 2005) whose resistance to reforms to which they are not committed is unlikely to be budged by aid, whether because surveillance is too weak or because there are pressures on donors to ensure that the aid keeps flowing, even when the agreed policy objectives are not being met.<sup>43</sup>

Just how serious is this moral hazard problem in the light of heightened levels of surveillance by multilateral institutions, as well as civil society groups, and of the credible threat of aid withdrawal in the light of declining flows during the 1990s, is an open question. Moreover, the general avoidance of programme aid by donors suggests that the problem is easily exaggerated. Nevertheless, the past may not be a helpful guide to the future if the doubling of aid calls for increased programme aid, and if donors anyway perceive it to be a problem then that perception may be sufficient to have a negative influence on how they allocate aid. Certainly, economists have understood that adverse selection in the face of moral hazard might produce undesirable (or sub-optimal) outcomes (Martens et al., 2002). Already, new selection procedures by bilateral donors shows signs of producing a bifurcated distribution, with aid favourites receiving more than expected and aid orphans receiving less. When those selection procedures include institutional performance there is a real danger of an immediate bias against low-income countries. This has been recognized as a pressing challenge for “fragile states” which, almost by definition, have a troubled institutional history.<sup>44</sup> However, the problem is more general.<sup>45</sup> Very few countries in SSA combine low growth rates and high levels of poverty with strong and effective bureaucracies. The appropriate response (as discussed further below) is to support the development of competent local bureaucracies and to ensure that government officials are accountable for their actions to local electorates and citizens. Such improvements will not occur over night and so the monitoring and coordination of aid will remain a sensitive issue in many countries. How this issue is addressed will be a key test of any new architecture for aid.

An alternative way of assessing the alleged distorting impact of aid fungibility is to see whether increased aid results in a reduced tax effort by recipients, a

combination which is likely to establish a culture of “aid dependency”. Identifying the right tax regime is, of course, the prerogative of sovereign governments and there is certainly no one best model for all countries and occasions. The IMF has suggested that low-income countries should have a tax-to-GDP ratio of 15–20 per cent (Gupta, Powell and Yang, 2006: 27). According to one recent study of 120 developing countries, the average tax to GDP ratio was 20 per cent, a figure very close to the current average for SSA (19.4 per cent). Indeed, given the size of the informal economy in many of these countries, the tax effort would appear to be robust (CFA, 2005:306). One recent study of the fiscal impact of aid in Ghana between 1966 and 1998 concluded that aid tended to induce both higher levels of current spending *and* increased tax effort, with policy makers seeing aid as an alternative to domestic borrowing. Ethiopia has also raised its tax to GDP ratio from 11 to 15 per cent since 1998 despite receiving a threefold increase in aid (UNDP, 2005: 97) This suggests that increased aid need not be inimical to sound fiscal policies (Osei et al., 2005).<sup>46</sup>

There is one important aspect of the aid-tax nexus that has a particularly strong bearing on the situation in Africa. It is often the case that if aid recipients are simultaneously liberalizing trade, either because of conditionality requirements or as a means to better absorb the inflow of funds, revenues from trade taxes (a particularly important source of government revenue in most poor countries) are likely to be falling, thus adding to budgetary pressures and further complicating the process of domestic resource mobilization. Evidence of declining revenues due to trade liberalization (both unilateral and multilateral) is certainly well established in the case of African economies.<sup>47</sup> One recent study found that low income countries (principally in Africa) were on average able to recover only around 30 cents of each dollar lost to fiscal revenue by trade liberalization (Baunsgaard and Keen, 2005: 22). This again raises obvious questions about the coherence of the policy advice pressed upon them in the context of aid conditionalities.

A final aspect of the fungibility problem concerns the risk of increased government spending crowding out private savings and investment. This could happen if the process of absorbing aid leads to higher domestic interest rates or if aid raises the marginal propensity to consume, thus reducing domestic savings. Some early empirical work (Griffin, 1970) found a negative relationship between aid and domestic savings in the recipient countries, a possibility that has been repeated by aid sceptics to suggest that aid intended to bridge the domestic savings-investment gap can actually widen it and lead to aid dependence rather

than self-sustaining growth. Again, apart from the methodological problems that beset all empirical estimates of the relationship between aid and domestic savings, such an outcome is by no means inevitable and has not in fact been confirmed by more recent research. Perhaps more significant is the evidence of public investment crowding in private investment, a result that appears to be particularly strong in SSA, albeit subject to a good deal of country specificity (Gupta, Powell and Yang, 2006: 27).

Perhaps the most serious issue raised by fungibility, concerns not simply the capture of ODA by ruling elites but their subsequent failure to use the associated rents for productive investment whether as a natural result of market forces as these operate in such societies or because of collusions and illegal practices or indeed of both sets of forces. This failure has been linked to the way in which aid generates a large revenue stream that is detached from the underlying economic activity, a characteristic it shares, to a certain extent, with natural resource rents. The resulting misallocation of these rents can retard development through capital flight resulting in insufficient investment in productive capacity or in human and physical infrastructure. One recent study has found that such behaviour by local elites has had a distortionary impact on growth in Mauritania and Kenya, and to some extent in Mozambique (Auty, 2006). Moreover, the commitment to doubling aid to Africa, under these circumstances, could quickly lose political support and momentum in donor countries, if it is seen to support “kleptocratic regimes” whose elites are richer than the average tax payer in donor countries.<sup>48</sup>

Without denying the possibility that aid can create incentive problems, it seems clear that in practice much will depend on country-specific circumstances, including the degree of strength and independence of the local bureaucracy, the degree of coherence between the objectives of donors and recipients and the room for, and use of, effective policy space in managing the inflow of aid. Bringing coherence to the activities of donors and coordinating them with the objectives of the recipient countries will be discussed in section E.2 where lessons are drawn from the Marshall Plan which had to handle similar issues in 1947.

## **(b) Institutional and personnel constraints**

Aid sceptics have been quick to warn about the diminishing return to aid which, regardless of past performance or the improving quality of aid management, could raise serious doubts about the likely impact of a rapid doubling of flows.

However, there is no consensus among scholars on the saturation point of aid, where diminishing returns would set in, with estimates ranging from as low as 4 per cent of GDP to as high as 50 per cent.<sup>49</sup> With this in mind, Annex table 1 shows the ratio of aid to GDP in 2004 for most African countries, with projections to 2020, based on the assumption that aid to all of them will be doubled by 2015 and remaining at that level to 2020. The average ratio in 2004 is 4.8 per cent, at the very low end of the saturation spectrum, with only 3 of the 47 countries crossing the higher end of that spectrum. What might happen subsequently with a doubling of aid depends essentially on what happens to economic growth. The table suggests that a 6 per cent growth rate is needed to keep the ratio stable, and this would begin to drop sharply if that rate is maintained when aid levels off after 2015. However, if annual growth is only 2 per cent per annum, almost half the sample gravitates towards the middle range of the saturation spectrum, although still only 4 exceed the upper limit. A good deal clearly hinges on the rate of economic growth.

Whether or not African countries actually have the institutional and human capacity to absorb a doubling of aid, there is general agreement that the ability to design and deliver policies tied to local needs and conditions, together with arrangements to ensure the accountability of politicians and policy makers if they fail to deliver, are prerequisites for any well-functioning public sector in SSA (CFA, 2005). A good deal of the discussion of that sector in Africa presumes that it is bloated and overrun by rent-seeking officials who are unlikely to spend any increase in aid wisely (Bates, 1981). All too often, these accounts of state activity and public policy in Africa are premised on a misreading of the economic history of Africa, forgetting the strong performance of a number of countries until the second oil shock (Mkandawire, 2001: 303–304). More generally, it is unduly influenced by the anti-state rhetoric that has marked the revival of neo-liberalism in many of the western democracies since the early 1980s and which is based more on ideological preference than careful analysis of the role and effectiveness of the state.

In fact, the nominal increase in aid to Africa from the late 1970s to the early 1990s coincided with a general rolling back of state activity, a development described by one observer as returning “full circle to the small government of pre-colonial days; but with the additional hysteresis effect from past shocks of a seriously depleted current institutional capability, deterioration in the current quality and scope of social services and infrastructure provision, coupled with a fiscal position highly vulnerable to changes in foreign aid” (Aron, 1996: 117).

Indeed, according to a World Bank study: "In many countries in sub-Saharan Africa, the civil service has sharply deteriorated in almost every way since 1970. Beginning in the 1980s, a succession of fiscal stabilization programs has reduced government employment in Africa to the lowest level of any developing region" (Schiavo-Campo, 1996).

At the same time, as pointed out by a number of observers, the large numbers of donors, all with increased aid programmes, overwhelm the weakened bureaucracies in recipient countries with a proliferation of negotiating, reporting and supervisory procedures. In 2002, the typical country in SSA had to deal with over 30 separate donors (UNDP, 2005: 100). In 2003, the United Republic of Tanzania received 230 donor missions, over and above ongoing donor meetings and has about 650 donor projects operating through either national ministries or local government; Ethiopia received 200 missions, Senegal 150, Mozambique 140 and Zambia 120 (Liebenthal and Wangwe, 2006: 5). At the same time, negotiations over debt management (including through the HIPC Initiative) and the ongoing PRSP processes place further demands on the time and energy of state officials. It becomes extremely difficult, if not impossible, to absorb and utilize the increase in aid effectively when so much professional energy and political capital is dissipated in dealings with donor agencies, diverting attention from mobilizing domestic resources and creating a consensus for the development programme (Kanbur, 2000: 419; Knack and Rahman, 2004). The problem is amplified by the proliferation of NGOs as disbursers of aid. Indeed, there is a very real danger of a vicious circle arising, as weakened state institutions encourage donors to by-pass them which in turn further erodes state capacities and leads to more aid being channelled through projects and non-government organizations.

This is also an environment that can breed corruption, on both a large and a petty scale. It is understandable that donors consider corruption a crucial issue, and African policy makers in recent years have made commitments to greater transparency and more effective monitoring and accountability in the handling of aid. Undoubtedly more can be done to insulate the core of the bureaucracy from political and financial pressures and to advance civil service reforms. There are, moreover, also dangers of state capture by business interests. Indeed, the steady emphasis over the past two decades on private sector development, particularly through attracting FDI and capital account openness, in combination with a weakened state sector and a poor regulatory and legal environment, has probably done more to fuel corruption in Africa than has aid per se, particularly as the latter was declining for much of the 1990s (UNCTAD, 2002: 55–57).<sup>50</sup>

However, it is probably the case, as suggested by World Bank field work, that the most pressing issues for the African poor concern irregularities and maltreatment in their daily contacts with public officials responsible for social services and the entire range of local administrative functions (Narayan et al., 2000).

It is against this backdrop of under-funded and over burdened state institutions and weak bureaucracies that the prospective doubling of aid raises a number of pressing issues linked to matters of state-building. Aid can undoubtedly be used to strengthen the necessary capacity, helping to push forward reforms that repair public sector institutions and promote growth. On the other hand, it can undercut accountability and capacity if the perception is that the policies belong to the donors and assistance is accompanied by a “confusing array of conditions, procedures and accounting requirements” (Schneider, 2005: 90). The evidence suggests that a proliferation of different donor-funded projects can undermine governance, ownership and the commitment to prioritize expenditure. Donor agencies can undermine administrative capacity in recipient countries by establishing parallel structures and poaching competent staff from the state bureaucracy, and as donor agencies proliferate such practices may well increase.<sup>51</sup> One recent study, for example, found a causal connection between donor fragmentation and poor bureaucratic quality in a sample of 96 developing countries, and that the extent of fragmentation and its damaging effects were greater still for a sub-sample of 30 SSA countries (Knack and Rahman, 2004). In addition, if donors favour sectors such as health and education, this may draw institutional and human resources away from less favoured sectors. It has also been observed, for example, that in a number of African countries the emphasis on Health and Education Ministries, and on Ministries of Finance in the era of budget support and PSRPs, has drawn human and other resources out of other ministries and left them less able to defend their programmes in the general budgetary negotiations. Ministries such as agriculture and trade and industry have become severely weakened in countries such as Malawi (Booth et al., 2006). This may also bias allocations within ministries or broad programmes. Thus, the worldwide attention and resources given to the fight against HIV/AIDS may have made it more difficult to increase spending on other chronic and deadly diseases.

The reform and strengthening of national civil services in Africa cannot be done quickly in response to the anticipated doubling of aid, even if part of the aid is used for that purpose (Stockmayer, 2005). It is an ongoing, complex and delicate process. That said, there are plenty of successful experiences to draw

on, including in Africa, some of which evolved out of periods of economic and political crisis.<sup>52</sup> It is also the case that the policies propagated by the major donors over the past two decades or more, despite being often sold as simpler to administer, have given policy makers experience in the complex demands of mixing and matching goals and instruments and making difficult trade-offs.

It is useful to distinguish between different levels of constraint facing state actors. Although there may be inadequate staff in central ministries, including skilled policy makers as well as accounting and legal personnel to manage an increase in aid, at the district and local levels the reverse is often the case. District officers, extension workers and local health workers throughout Africa are often under-resourced and unable to fully use their productive capacities (White, 2005). Aid, by providing them with equipment and resources, could harness their underutilized capacity with considerable effect. This might be taken as a pointer to the need for donors to be more creative in mobilizing district and local government institutions in the delivery of aid, an approach that would be in keeping with the rhetoric of many donors about decentralization in developing countries. However, it would be a mistake to try to bypass central authorities which anyway must eventually assume full responsibility for all levels of government. Work by Conyers and Mellors (2005) has provided good examples of experience in several African countries where aid was channelled through government agencies and integrated with efforts to build the capabilities of elected local councils in a manner that also strengthened the links between central ministries and local government. As will be discussed later, this is part and parcel of the process of channelling aid through budget support, alongside measures that help to buttress strong public finance systems.

Even at the level of central government, problems of absorptive capacity are not inevitable. Aid itself can help to overcome them if it is effectively used to develop the institutional and human resource capacities of the recipients. A softening of state structures is not an insurmountable obstacle to, or inevitable outcome of, increased aid. Both donors and recipients must recognize that aid quality, governance and economic policy can improve over time. The recent stress on “ownership”, “accountability” and “transparency” certainly suggests a desire on the part of donors to move away from the anti-state position that dominated thinking of the last two decades or so, enabling a number of countries to begin implementing more ambitious state-building agendas requiring far-reaching changes in the systems of government, including law and justice, the

retooling of the civil service, reversing the brain drain, and repairing the main institutions of training.

## 2. Aid delivery

There is a growing awareness among donors that their own actions and behaviour are just as important for the effectiveness of aid as those of the recipients. Indeed, the inclusion of such phrases as “mutual responsibility”, “partnerships” and “dialogue” as part of the current aid lexicon is a clear recognition of past mistakes. As stated in the Paris Declaration, the objectives of donors are now systematic support for recipient-owned plans for the attainment of development results; increased use of national administration systems; and more coordinated and predictable actions among the multiple aid actors (Rogerson, 2005).

Acknowledging the current state of affairs is an important step forward. What is much less certain is how the multilateral dimension is to be integrated into a more effective system for delivering aid. As previously noted, multilateral aid to Africa currently accounts for less than 30 per cent of the total, and the small increase over the past decade has been largely due to debt relief. Resistance to a more multilateral approach can be explained, in part, by the lingering influence of a Cold War geo-political ideology, by persistent uncertainties about the role of the United Nations in the aid agenda, by doubts about the evolving roles of the international financial institutions, as well as by a general sense of incoherence among the broader family of multilateral development institutions. At the same time, there has been reluctance among donors to downgrade project aid (and its attendant degree of influence), which would be a likely consequence of any move towards a greater multilateralization of aid delivery.

This section reviews some of the main issues that have emerged from recent discussions of aid delivery and suggests some of the principles that might be used to guide a greater multilateral funding of African development.

### (a) Politics and public goods

At present there are approximately 75 official aid agencies operating around the developing world – 40 bilateral, 20 multilateral and 15 United Nations



agencies. There has been a high rate of new entrants recently with countries such as China, India, Thailand, the EU accession countries and even Scotland setting up their own programmes, and new funds created such as the Millennium Challenge Account and the Global Fund to fight AIDS, Tuberculosis and Malaria (GFATM). Since the commitment was made to double aid, a number of new initiatives have emerged specifically for Africa, including the World Bank’s Africa Catalytic Growth Fund and the Investment Climate Facility. An EU Trust Fund in support of African infrastructure development has also been launched in 2006. As already noted, the number of NGOs participating in the aid process has been growing rapidly since 1991 (Epstein and Gang, 2006).<sup>53</sup> With few organizations leaving the scene, the aid arena has become a very crowded and chaotic place.<sup>54</sup>

Donor fragmentation, as noted earlier, is particularly high in most African countries, indeed considerably higher than the average recipient (World Bank, 2005a:171–172). The previous section identified some of the consequences for aid recipients. In addition, problems have been mounting on the donor side in terms of high administrative costs, large rates of turnover of agency staff, excessive use of consultants and lack of institutional memory. Tackling these problems has begun to be addressed through the better coordination of aid budgets and activities. Donors signed a commitment to improve the harmonization of aid in Rome in 2003 and, more recently, the Paris Declaration on Aid Effectiveness set out five basic principles for donors concerning ownership, alignment, harmonization, management and accountability, together with a set of 12 indicators which could be used to judge whether or not fragmentation was diminishing and coordination improving. Moreover, donors and recipients have committed themselves to an international monitoring process, with work already started on standardizing technical guidelines, survey instruments and data collection. Efforts are also under way to improve the management of field operations and the harmonization of donor missions. Pilot programmes have been set up in a number of African countries, including the identification of lead donors for common funding of specialist programmes. Still, progress is uneven (UNDP, 2005: 102).

In terms of the quality of aid, and on the basis of a whole series of performance indicators, multilateral flows appear to set a higher benchmark than bilateral flows. The former, *inter alia*, tend to be less politically motivated, are more open to competitive tendering, are likely to be more focused on the longer-term and are more predictable (CBO, 1997: 36). Although measurement problems

abound, there is a growing body of evidence that supports this conclusion in terms of it generating more favourable outcomes.<sup>55</sup> It would be wrong, however, to suggest a simple bifurcation between two systems of delivery. In terms of aid quality, the performance of different donors, taking into consideration issues such as the tying of aid, the focus on poverty, its allocation to countries with good policies and institutions, and the amounts given as technical assistance and project aid (both deemed to have negative features), has been the subject of several studies (McGillivray, 1989; Dollar and Levine 2004, Roodman 2005). The resulting indices of aid quality are reassuring for the commitment to double aid in that they show countries giving most aid relative to their income, for example, Denmark, Ireland and Norway, scoring well, in contrast to those that give relatively little. This suggests that as donors increase their aid, there is no intrinsic reason why its quality should not improve in tandem.<sup>56</sup>

Aid success stories, as discussed in the previous section, can in part be traced to a shared vision among donors and recipients. One obvious problem with growing donor fragmentation is the difficulty in establishing common priorities and objectives. In their absence, the politicization of aid, tied to an array of specific donor interests, seems all the more likely. The fact that the current commitment to double aid to Africa has been made against a backdrop of renewed doubts about development priorities and the means to achieve them raises further questions about coherence. On one level, this can be taken as a welcome admission that donors do not have superior knowledge and that tailoring aid to local conditions can only be done through genuine local ownership. However, just how much ownership donors are willing to cede to recipients remains an open question. Certainly, “aid still comes with a bewildering array of strings attached” (UNDP, 2005: 99) and the failure to clarify the relation between ownership and conditionality contributes to the persistent levels of volatility and unpredictability surrounding aid to Africa. The alternative, as Stiglitz (2001) recognizes, certainly means rejecting a one size fits all development model and accepting a degree of fuzziness into the policy debate. Nevertheless, some degree of agreement among goals and objectives is still likely to be a condition for establishing a constructive partnership between donors and recipients (Ranis, 2006).

The value of establishing a set of guiding criteria underpins the growing consensus around the MDGs. Such a consensus emerges from the interface of moral values and enlightened self-interest and, arguably, the possibility of achieving a more satisfactory balance between them is a major attraction of following the multilateral route. Moreover, doing so appears to match the preferences

of citizens of donor countries to the extent that they perceive multilateral aid as being handled with greater expertise, being relatively more insulated from distortionary political pressures, and offering efficiency gains through economies of scale and scope (Lancaster, 1999). To date, multilateral mechanisms have been more acceptable to donor governments when aid is linked to the provision of global public goods, such as economic stability, the environment, health and humanitarian assistance, all areas in which bilateral delivery can give rise to severe agency problems, such as free-riding, adverse selection, and moral hazard (Stiglitz, 2002a).

A number of observers have reported a steady shift in the use of ODA towards providing global public goods, such as improved health and environmental conditions, but expanded to include poverty alleviation.<sup>57</sup> On the one hand this reorientation of aid budgets seems to reflect a more tangible return to donors. On the other, it reflects the changing orientation of the international financial institutions away from their original mandate of mobilizing and managing collective responses to international market failures to, in the apt phrase of Joseph Stiglitz, that of “champions of market supremacy” (Stiglitz, 2002b: 12). However, moving in this direction carries the danger of uncoupling development assistance from more traditional objectives of stimulating economic growth and accelerating industrial development in a sub-set of the global economy.

Arguably, and in parallel to their funding at the national level, the provision of global public goods could be dealt with through international taxation measures<sup>58</sup> rather than through nationally funded aid budgets. Still, it would be wrong to ignore the “public” dimension of development aid linked, in particular, to the idea of shared prosperity.<sup>59</sup> To the extent that there are positive spillovers to rich countries from faster growth in poorer areas (in terms of enlarged markets, more profitable opportunities for investors, and technological rents), there are obvious benefits for donor countries from an effective aid system.

However, as there are no guarantees about the resulting direction of trade and investment flows, shared gains to the donor community will depend on a large number of poorer countries experiencing rapid growth. This dimension of development aid goes some way to explaining its undersupply, not only in terms of the persistent failure to meet the United Nations 0.7 per cent target, but also of the particularly low share of the multilateral component. Given the prospect of a doubling of aid flows to Africa, sorting out these issues is a necessary prelude to their more effective use.

## (b) Grants and loans

ODA comprises both grants and loans with a grant element of at least 25 per cent. The share of grants in bilateral aid has been steadily increasing since the early 1980s, albeit still below their level in multilateral flows (Gupta, Pattillo and Wagh, 2006: 7). However, much of that increase is explained by the growing weight of technical cooperation and debt forgiveness. It has also been suggested that the designation of what constitutes a loan overstates its aid contribution because the full amount of the loan is included under ODA (Chang et al., 1999). But whether in the form of outright grants or concessional lending, ODA involves some form of subsidy, and the real issue is under what conditions one or the other modality is best for generating faster economic growth and poverty reduction. From this perspective, the question of aid effectiveness cannot be wholly detached from the wider issue of development finance.

There is a growing acceptance, endorsed by the Monterrey Consensus in 2002, that most aid to low-income countries should take the form of grants rather than loans.<sup>60</sup> The CFA (2005:313–314) also recommended that increased flows should consist “mainly of grants”. The rationale for this includes the greater ease of disbursing grants, their predictability and their more precise focus on development objectives. Moreover, grants rather than loans, especially to low-income countries, avoid increasing already unsustainable levels of indebtedness, a particular concern for many countries in SSA.

At the multilateral level, further moves towards the greater use of grants will certainly have implications for the provision of development finance more broadly defined. Since the early 1980s, the distinction between the hard and soft lending windows of the multilateral financial institutions has been increasingly difficult to draw, as these institutions have become gatekeepers for countries wanting to access private capital markets. At the same time, a large proportion of multilateral development finance has come to rely on aid rather than the regular resources of these institutions. The International Development Association (IDA), the soft-loan window at the World Bank, is its only source of net finance for developing countries. Net flows from the International Bank for Reconstruction and Development (IBRD) to SSA are negative and it is only IDA funding that makes the total positive, albeit less than \$2 billion, under 10 per cent of what is being suggested by the doubling of aid. The amounts channelled through the IMF, notably the Poverty Reduction and Growth Facility (PRGF), are even smaller. The African Development Fund (ADF) of the African Development Bank Group (AfDB) is increasingly becoming a significant source of concessional funds for

its 38 Category A (or ADF/IDA-only) regional member countries.<sup>61</sup> Resources available through this concessional window have more than doubled since the completion of its ADF-VIII cycle (1999–2001) from around \$2.0 billion to \$5.4 billion during the current ADF-X cycle (2005–2007), although this is still very small relative to Africa’s aid requirements and the number of countries among which this is allocated over the three-year ADF cycle (AfDB, 2004 and 2005).

However, the replenishment exercise behind both the IDA and the ADF makes them heavily dependent on a small number of key donors, leaving much scope for political leverage on their own governance. While both funding windows have been instrumental in shifting the emphasis of aid from projects to the support of more coherent programmes, including sector-wide approaches (SWAPs), the degree of local ownership remains unclear. In the case of IDA, there is also evidence of diverging treatment of recipients: one recent review of its delivery mechanism has contrasted the “paternalistic approach to SSA” with a more deferential approach in South Asia, with performance assessment in the former linked to procedures and intermediate inputs rather than, as in the latter, ultimate objectives (Abegaz, 2005: 446).

In the light of these developments there is an increasingly strong case for the softer component of development finance to be separated from the traditional lending activities of the IFIs. The latter is connected to the issue of debt sustainability and to the larger question of (inadequate) access for developing countries to international capital markets. Although it is up to sovereign nations to decide whether to enter into bilateral agreements on debt and financing, the multilateral system has a role to play through the provision of short-term liquidity, through assessing social rates of return on investments and through certain types of project lending which involve a prominent public-private sector partnership (Cohen et al., 2006).<sup>62</sup> The debate is ongoing about what this implies for the reform of the international financial architecture (UNCTAD, 2001b); however, it would seem that the place of the more donor-driven grant-based facilities in the Bretton Woods institutions (BWIs), i.e. the IDA at the World Bank and the PRFG at the IMF, should be much more clearly separated from their lending roles in order both to achieve more effective delivery of the resources and to improve their own governance (Akyüz, 2005).

Switching to grants does not, however, meet with universal approval. Some of the doubts concern the practicality of converting financing agencies into development funds. Others raise concerns about a perceived tendency of grants to weaken the domestic tax and savings effort and to finance consumption

rather than growth-enhancing investment.<sup>63</sup> However, as with the effect of aid in aggregate on fiscal effort examined earlier, there is no consensus on this issue. Nevertheless there is a tendency to exaggerate the scale of the problem. Morrissey et al. (2006), for example, were unable to confirm any negative effects of grants on growth in Kenya.<sup>64</sup> Another argument against grants is that they are more subject to political discretion and financial vulnerability. Donors who provide them on a bilateral basis may find their resources dwindling, thus possibly making them more reluctant to replenish the multilateral funds of institutions such as the World Bank, which would then find it difficult to maintain its own grants endowment from the repayment of loans. This may be problematic in a multi-objective environment in which aid is a scarce public good (Klein and Harford, 2005: 64–65; UN, 2005a: 123) and where, as is currently the case, replenishments can be amplified through a larger disbursement of soft loans or combined with other types of assistance.

The above concerns serve as a reminder that there are arguments both for and against the use of loans and grants in the context of development finance. They also highlight the importance of individual country circumstances when deciding upon the best mix of loans and grants. However, they do not weaken the case for a more extensive use of grants in supporting a big push for African development, where the frontloading of aid is judged to be desirable to build up public infrastructure (road, ports, telecommunications, etc.), support human capital development and accelerate fledgling private capital accumulation. Rather, they suggest that the provision of grants needs to be accompanied by appropriate measures to strengthen domestic institutions and policies to support domestic resource mobilization. They also imply changes in the mechanisms and modalities at the multilateral level for dispensing grants. This will be discussed in greater detail in the next section of the report. Furthermore, the discussion on the use of grants is taking place amid new thinking on alternative sources of development finance among which are an International Finance Facility, global taxes such as airline passenger taxes, carbon taxes, a global lottery and an increase in special drawing rights.<sup>65</sup> How these might fit into a new architecture for aid is likely to be central to the ongoing debates on aid delivery.

### **(c) Projects and budget support**

It is no secret that aid serves the multiple commercial, diplomatic, political and strategic objectives of the donors. This has strongly biased aid towards bilateral,

project support that continues to account for an overwhelming proportion of aid to SSA (Gupta, Pattillo and Wagh, 2006: 16). The case against traditional project aid is persuasive: it makes governments accountable to donors rather than their own tax payers; it takes spending decisions out of government hands and puts donors in charge; and it creates parallel bureaucratic structures which absorb scarce local resources. The time and energy taken up with meeting and dealing with a plethora of donor missions and organizations was noted in section D.1.(b), but coordinating and tracking the resulting projects places even greater burdens on the administrative structures of the recipient countries. In the mid 1990s for example, 405 donor-funded projects were identified in the Ministry of Health of Mozambique: as Kanbur and Sandler (1999) note, even an excellent bureaucracy would have trouble coordinating and accounting for so many projects!

The problems are magnified in the case of tied aid, where poor quality tends to reduce both the real value of the resources transferred (particularly through the purchase of goods and services exclusively from donating countries) and their developmental impact. The cost is high: the UNDP (2005:103) estimates that SSA loses between \$1.5 and \$2.3 billion a year (see also endnotes 13 and 14). However, this is underestimated as it only covers bilateral aid and does not take into account technical assistance. Examination of individual donor budgets points to a much higher figure. Tying aid is particularly damaging to the self-sustaining growth model in that it encourages import dependency and hence does little to narrow the foreign exchange gap that aid initially fills. Although some countries such as the UK have significantly reduced the tying of their aid over the past decade, other donors have been more reluctant to do so.

Budget support appears to be the most sensible option for delivering the kind of aid that is increasingly seen as necessary to put Africa onto a new growth path. Such aid is essentially channelled to government budgets and disbursed under their own systems for allocation, procurement and accounting. It is more likely to reflect national priorities, to promote national ownership by encouraging the use and strengthening of national arrangements for planning, budgeting and accountability, to keep transaction costs to a minimum and to have stronger links to public investment.

Despite its advantages, budget support only accounts for around one quarter of total aid (World Bank, 2006:81) and is lower than in the early 1990s. Indeed, as of March 2005, only eight African countries were receiving active budget support (Liebenthal and Wangwe, 2006).<sup>66</sup> It seems sensible to move much further in

this direction in the context of a doubling of aid. Arguments from aid sceptics about fungibility and fiscal problems with such aid (see the previous sub-section) appear to be exaggerated (Mavrotas, 2005) and a study, commissioned by the UK's Department for International Development (DFID), of budget support in India, Mozambique and Uganda confirms its advantages (Warrener, 2004).

However, moves towards greater budget support should be pragmatic, sensitive to local realities and ready to accept that other methods of disbursement will also be necessary. Such moves may be undermined in the absence of accompanying measures to reduce a country's debt burden (Quartey, 2005). There are also signs that some donors, in their anxiety to disburse funds, have perhaps been overly optimistic in their assessments of fiscal processes and governance in a number of African countries (Booth et al., 2006). However, for weak or compromised bureaucracies, and those recipient countries with weak budgets, there seems little alternative to project aid if they are not to be cut off completely from development finance. Perhaps the most viable solution in such cases is non-fungible project aid supported and complemented by a comprehensive programme to strengthen fiscal systems and accountability. It is also the case that the problem of predictability of aid disbursements is likely to increase when aid is for budget support, since the demands on policy makers are more exacting. This again highlights the importance of bringing into the discussion of aid issues such as public finance reform and the effective management of public expenditure, areas where donor performance has been particularly weak (Berg, 2000). Efforts are under way among donors and the appropriate international agencies to harmonize their practices through an integrated assessment of public sector management. Coordination and harmonization issues have begun to coalesce around budget or programme support and, in some cases, around SWAPs which began in health and education but have now gained wider appeal.<sup>67</sup>

#### **(d) Reformers and performers**

The political commitments attached to bilateral aid are often (and with some justification) contrasted with the technical knowledge attached to multilateral aid. Indeed, the generation and dissemination of such knowledge is often seen as among the principal advantages of employing multilateral institutions to distribute aid (Gilbert et al., 1999). But while these can certainly help counter the undersupply of such knowledge, it would be misleading (as already suggested in section (b) above) to ignore the political pressures shaping decision-making



in multilateral financial institutions. Conditionality – understood broadly as the “means by which one offers support and attempts to influence the policies of another in order to secure compliance with a programme of measures” (Buiru, 2003: 3) – has been attached to multilateral financial flows since the early 1950s raising a set of perennial questions about the space between national sovereignty and multilateral disciplines. In an interdependent world, such disciplines and related surveillance activities are unavoidable. However, this has been a shifting terrain, with fundamental changes after the richer countries abandoned multilateral financial support in the 1970s.<sup>68</sup> In the 1950s and 1960s, when a large proportion of aid went into infrastructure development, conditionality was limited. There were, of course, regular assessments of the development policies and prospects of individual recipient countries, but these were primarily to ensure project implementation and the creditworthiness of borrowers, not with a view to specifying a detailed policy programme. That changed in the early 1980s when the development mandates of the IFIs were expanded. As multilateral aid concentrated more and more on adjustment lending, conditionality was crafted with the explicit aim of shifting policy making in borrowing countries towards more market-oriented development strategies (Ahluwalia, 1999: 3–5).

The question of conditionality is probably among the most controversial of all the subjects in the debates over reforming the architecture of aid. A broad body of opinion accepts that policies matter, both for achieving faster growth and for sharing its benefits more widely. But what those policies are – or should be – remains contentious. As discussed extensively in past UNCTAD reports, the policy options promoted under the Washington Consensus have largely failed to stimulate strong growth recoveries in the countries adopting them, and the evidence that these have led to adjustment without growth is now compelling (World Bank, 2005b).<sup>69</sup> There has also been a growing recognition that the conditionality principle has more and more clashed with that of ownership, all the more so as finding what works depends on an appreciation of local conditions and sensitivities. Indeed, from the head of the IMF to the CFA, the call over the past few years has been for a serious pruning of conditionality.<sup>70</sup>

Given the importance of “local heresies” in unlocking economic growth and societal transformation, the emphasis needs to be on experimentation and thus on the availability of sufficient policy space (Birdsall et al., 2005). Moreover, with no guarantees of what will lead to success, accepting the possibility of failure means being able to try again without the threat of automatic penalties. Indeed, such penalties may make the problem chronic. What is needed is *ex ante* coherence in economic programmes, subject to *ex ante* discussion and debate, which are backed up with sufficient and predictable levels of aid. Success will be ultimately

be rewarded by the market and the task of aid donors is to try again with the failures and search out new routes to success. The logic has been spelt out by the German Development Minister at a recent meeting of the World Bank's Development Committee in 2004:

Development institutions, in particular the Bank and the Fund, should actively advise on a range of policy alternatives and thus create "policy space" for the countries. Here it is not so much a question of "policy advice" in the classic sense. Rather, the role of the IFIs is to identify trade-offs, show possible alternatives policy options, make experience from other countries accessible and contribute to the establishment of national analytical capabilities. A further streamlining of conditionality and focusing performance criteria on output indicators would also contribute to ownership

A very different response has been to suggest that policy conditionality has actually had little success in influencing policy reform, and that aid has continued to support "bad policies" as much as reforming governments. Combined with the (heavily publicized) claim that aid can promote growth and help reduce poverty only if it is granted to countries that have adopted good policies and institutions, this has led to calls for the international community to shift its funding and monitoring activities to "good performers" (Burnside and Dollar, 2000). On this argument, aid is to be used not so much to help produce winners as to reward them. If this advice is followed, and there are already signs that it is, it would have important implications for the allocation of the doubled volume of aid: the potential increase of \$25 billion in aid to SSA would go to favoured partner countries that are performing well according to donor performance criteria.

The logic of this approach raises a number of serious questions of both an economic and ethical nature. First, selecting aid recipients on the basis of their good performance is not as straightforward as is sometimes suggested. Measuring it, as for example through the Country Policy and Institutional Analysis (CPIA) used by the World Bank, is still non-transparent and the product of subjective judgement. Moreover, progress on any criteria is likely to take time to materialize and is subject to cyclical fluctuations, shocks and discontinuities. Consequently, linking aid to performance may still fail to address the problem with the volatility of flows. Certainly in the case of Africa, external conditions are a major determinant of its economic performance and removing these from the rationale for aid is likely to be seriously distorting (Guillaumont and Chauvet, 2001). African countries have been variously classified as good and bad performers quite independently of their commitment to reform (UNCTAD, 1998; Vreeland, 2003). In fact, the tendency is still to assume that the same

good policies and institutions are applicable regardless of country preferences and specificities, and with performance-related aid still likely to embody high levels of conditionality.<sup>71</sup>

Second, there is a question about whether good performers need more aid. Viet Nam has been singled out recently as a country that has achieved economic success without large inflows of aid, but does it follow that increasing aid must be the right response? In fact, a good deal of evidence, as has already been noted, suggests that aid works regardless of conditions or, indeed, that aid can influence policy choices and that it can be more effective under weaker conditions, for example where the level of human capital is lower (Gomanee et al., 2005) or in economically vulnerable countries (Chauvet and Guillaumont, 2004). There are also important question to ask about countries that are not classified as worthy of aid, as well as to the neglected poor among the middle-income countries that are likely to fall off the aid radar. The neglect of middle-income countries is sometimes defended on the grounds that they are increasingly able to access the international financial markets and often prefer such funds to aid. However, in the light of the strongly pro-cyclical and herd behaviour that characterizes private capital flows, this is doubtful. Thinking along the lines of good performers is likely to detract attention from the more important issue of how to ensure complementarity between aid and domestic resource mobilization under different economic and political circumstances in ways that will encourage the emergence of virtuous circles of sustainable growth and development.

Finally, it is not just good performers but low-income good performers who have been identified as the intended beneficiaries of the increase in aid. This is potentially good news for many countries in Africa, but it seems likely that this will reintroduce new conditionalities in the form of governance or welfare criteria as the measure of good performance. As Killick has pointed out (ODI, 2004), despite the talk of partnership replacing conditionality, the new forms of conditionality embodied in the PRSPs are not consensual and the number of conditions in World Bank and IMF programmes has only fallen slowly and those that are legally binding have fallen least of all. Indeed, as policy makers in Africa become increasingly uncomfortable with the social welfarism embodied in the PRSPs' development strategy, it seems they are responding by simply second guessing what donors want to see in the country's PRSP even when they feel it is not appropriate (UNCTAD, 2002).

There are already signs of donor tensions emerging around the issue of reserving aid to good performers. Although it is clear that some of them prefer such an approach, especially in Africa, others donors may not. The UN agencies,

for example, continue to spread their aid more widely and still have 5,000–6,000 employees and 5,000–6,000 consultants in what has been referred to as the “forgotten states” (ODI, 2004:4). At the same time, the United States Agency for International Development (USAID) seems to be becoming increasingly concerned with fragile and failing states as a degree of geo-political interest begins to influence its aid allocation.<sup>72</sup>

The Monterrey Consensus accepted that aid should be results oriented, while being adamant that ownership and flexibility be fully reflected in the principles of aid management. There are no simple formulas for achieving this balance. However, for some analysts, combining these features requires a bolder approach to aid delivery in which donors really do cede control to independent multilateral bodies. In the case of Africa, reference to a Marshall Plan has echoed this line of thinking, but there are also lessons to be learnt from more contemporary efforts such as the EU’s use of common funds in support of its own regional development (Abegaz, 2005). Some of the implications of these discussions will be picked up in the next section of this report.

## E. Rethinking the aid architecture for Africa

The kind of “big push” discussed in section C presents a considerable challenge to both the international community and to African policy makers. Nevertheless, specific historical experiences as well as the broader body of empirical evidence on the impact of aid on development offer grounds for optimism. While the recent commitment to doubling aid to the region over the coming years implicitly acknowledges the economic logic behind a big push, the debate on whether or not an effective system for managing such an increase is in place is ongoing and contentious.

The previous section identified a number of key issues which are central to the discussion of an effective aid architecture for Africa. In particular, it suggested that aid remains too politicized, too unpredictable, too conditional and too diffused to act as an effective catalyst for the kind of investment-led growth and structural change that is needed in the region and that could make a significant and lasting reduction in poverty.

## 1. Market versus planning approaches

Talk of the aid “system” or “architecture” is commonplace but in reality the aid business has grown in fairly chaotic and unplanned ways with the entry of numerous and various types of new agencies since the establishment of the Bretton Woods system. Under that system, a relatively small number of donor countries and multilateral institutions initially dominated the structure, albeit with most aid delivered under bilateral arrangements. As a consequence, while early multilateral aid efforts emerged as a legacy of the Marshall Plan and were influenced by the big-push economics of the early pioneers of development policy, the aid architecture was shaped much more fundamentally by the desire of former colonial powers to maintain continuity in their relations with the newly independent countries and by the geo-politics of the Cold War. Already in the late 1960s, questions of systemic effectiveness were being raised and in the mid-1970s, Gunnar Myrdal (1975) in his Nobel acceptance speech argued that the system had not only failed to deliver a sufficient quantity of aid, but also, and in his view more importantly, aid of the required quality. This he attributed to the undue politicization of aid budgets. Thirty years later, the CFA (2005: 311–312) acknowledged that donor influence had continued to distort the system for allocating aid to African countries, albeit putting more stress on it being “haphazard, uncoordinated and unfocused, to a degree that should be unacceptable”. If aid is to double to Africa, then it has to be asked whether the present organization of aid can deal with increases of the proposed magnitude in a way that can trigger the strong and cumulative growth described earlier, whether some minor repairs are all that is needed or whether more deep-seated reforms are required if the desired outcomes are to be achieved.

There are at present two schools of thought regarding this issue. On the one hand there are those who feel that the aid business should be allowed to develop in a fairly unregulated manner, much like a competitive market, and that at present its efficiency is hampered by cartel-like structures and by overly ambitious governments. On the other hand there are those who argue that the doubling of aid needs to be accompanied by a much more carefully planned and restructured system for allocation and delivery.

The former argument is based on the belief that donor proliferation will spur competitiveness and experimentation, with weak and poorly performing aid agencies dropping out of the picture. In this vein, Easterly (2005), for example,

argues that “Anecdotal evidence suggests that piecemeal approaches to aid are more successful”. There are certainly plenty of signs, as discussed earlier, that the aid industry has already become much more competitive with new agencies entering and none exiting. According to the proponents of the market approach, the way to ensure delivery in this environment is to promote individual agency accountability for specific tasks where the real challenge is to find interventions that work and to keep them going with the right incentives, whether through the independent evaluation of projects, more feedback from intended beneficiaries, or the prompt withdrawal of funding for delivery failure.<sup>73</sup> A related view of the aid industry, which harnesses the competitive effects of the market, is a service credit scheme (Easterly 2002) whereby credits provided by donor agencies are used by recipients to buy technical assistance and other services from accredited agencies and commercial service providers in the open market. Here, the role of the donor becomes reduced to providing funds and accrediting the service providers, of which only the most efficient will survive in the new market. The aim is to increase the amount of aid and reduce the transaction costs of delivery.

There are grounds for scepticism, however, regarding this vision of an increasingly competitive aid industry based upon the market model. Aid agencies are needed, in part, precisely because private financial markets do not operate perfectly, and this fact alone should give pause for thought. Such a vision implicitly assumes well-functioning, competitive markets where recipient countries have access to perfect information about all possible opportunities, agencies and service deliverers. This is hardly a plausible description of conditions in most aid-receiving countries in Africa and there is a vast theoretical and empirical literature showing why some centralized coordinating authority, to establish surveillance and oversight and to provide corrective ingredients, including for information gaps, is needed if markets are to work properly (Adelman, 2000). In fact, and as noted previously, there is strong evidence, particularly for Africa, that the more fragmented is aid delivery, the more damaging is its impact on bureaucratic quality and, by implication, on aid disbursement (Knack and Rahman, 2004). Moreover, the evidence on the impact of aid, as discussed earlier, is much more nuanced than most advocates of the market model are willing to acknowledge, while much of the criticism of traditional aid channels is greatly exaggerated. It should also be emphasized that well-functioning, efficient markets usually emerge as a result of development not as a precondition for it (Lazonick, 2001). In addition, the “aid as a market” approach is vulnerable to the charge of being amoral. When it talks of failure as a route to competitive efficiency it says nothing of those recipient countries and those people who will suffer in the process. For all these reasons, donors, as they made clear in the Rome and Paris Declarations,

are in favour of aid harmonization and appear to accept that the chaos of the market does not provide the right model for a reformed aid architecture.

The arguments against the market model, and in favour of relying more heavily on a well-planned architecture, even if it does involve a degree of cartel-like operation, rests in part upon the existence of market failure. Overcoming barriers to information gathering, preventing excessive duplication, closing delivery gaps, etc. will all involve some kind of coordinated planning. At the same time, to the extent that aid possesses some of the qualities of a public good, it can only be really effectively handled through collective action. Such action can face free-rider problems in the face of multiple agents, i.e. there is an incentive for any one donor to hold back on activities that maximize overall development in favour of those that contribute to the donor’s specific goals. But this is not inevitable, and a recognized element of altruism can have a major bearing on aid flows, although it may well be stronger in some countries than in others. Coordination and cooperation among donors through multilateral organizations is a necessary response to the free-rider problem. The UN Millennium Project (UN, 2005b:31) in recent years has been in the vanguard arguing for just such an approach:

The core challenge of the Goals lies in financing and implementing the interventions – for two reasons. One is the sheer range of interventions that should be implemented simultaneously to reach the Goals. The second is the need to reach large proportions of the population. National scale-up is the process of bringing essential MDG-based investments and services to most or all of the population, on an equitable basis, by 2015. Scale-up needs to be carefully planned and overseen to ensure successful and sustainable implementation. The level of planning is much more complex than for any single project.

This is not to say that there is no room for well-harmonized aid agencies cooperating with the private sector. There is plenty of scope for hybrid development banks that provide loans and assistance to the private sector and there have been interesting experiments of output-based aid where private operators have built water and sanitation services and then been paid from donor funds whilst also receiving a subsidy to connect poor households (Klein and Harford, 2005, chapter 12). Easterly (2006) also provides many examples of successful local public-private schemes, including some with multilateral funding. The emphasis, nevertheless, is on a better coordinated, multilateral approach to the aid effort than is currently in place or implied by the market model.

## 2. Lessons from the Marshall Plan

Faced with complex and interdependent problems or with the consequences of major disasters, politicians, particularly those in Western Europe, have increasingly called for a “Marshall Plan” as part of the response.<sup>74</sup> In many cases these initiatives have failed to move beyond the initial call, partly because finance ministers in the developed countries in the 1990s were grappling with fiscal deficits and were reluctant to listen to proposals that suggested large increases in aid budgets. But perhaps more importantly, such calls went against the tide flowing in favour of free markets and foreign private investment as the remedy for development problems.

A growing awareness of the close links between economic and political security, post 9/11, as well as growing doubts about the ability of free markets to trigger development, has led to rather more urgent calls for action on the scale of the Marshall Plan to deal with such fundamental problems. British Prime Minister Blair picked up the theme, citing the North-South divide between rich and poor as a fundamental factor in the growth of terrorism, and in December 2001 Chancellor Gordon Brown proposed a “New Marshal Plan” which would double the aid provided by the rich countries to the poor ones. Three years later, on 17 December 2004, the Chancellor, speaking in New York, continued to stress the tensions between the rich and the poor and argued that if the west failed to open its markets to developing countries, forgive debt and provide more generous aid, there was a real risk of “permanent guerrilla war”: “We need to make an offer as bold as the offer that was made in the Marshall Plan of the 1940s”. The Prime Minister and the Chancellor again called for a “Marshall Plan approach” to African development in the run-up to the G8 Summit in Scotland in 2005.

It is important that such calls are not seen simply as goodwill financial gestures to countries in need. Indeed, there are many critics who do see them in these terms and dismiss such ideas on the ground that large sums cannot be absorbed efficiently by the receiving countries and that they are likely to fall into the hands of corrupt politicians and government officials. Given the commitment of the donor countries to double aid to Africa, as well as the issues and criticism discussed in section D, it is worth recalling the motives behind the introduction of the Marshall Plan and especially the ways in which it organized large monetary



transfers to European economies plagued by bottlenecks of various kinds and a wartime legacy of widespread destruction of productive capacities.

The Marshall Plan of 1947 was certainly generous, providing Western Europe with some \$12.4 billion over a four-year period, most of it in the form of grants rather than loans. The programme amounted to just over 1 per cent of the US’s GDP and over 2 per cent of the recipients’. The Marshall Plan did much more, however, than supply Europe with much needed dollars; it also introduced a framework of organizing principles intended to ensure that the aid would be used effectively and encourage policy makers to forge a new kind of “social contract” that would be radically different from the deflationary and divisive actions of the inter-war period (Mazower, 1998: 299). These aspects of the Marshall Plan are often obscured in current suggestions for a “new” version, but it is precisely here that useful lessons can be drawn for development policy, including for Africa.

When critics object to proposals for “new” Marshall Plans for certain countries on the grounds that they are not democracies or do not possess market economies, they forget that Marshall Aid was not so demanding: Italy and West Germany adopted democratic institutions only in 1948 and 1949, and in Italy many of their provisions were ignored as part of the strategy to keep the Communist Party out of power. Although most of the institutions of a market economy did not have to be built from scratch, the various European economies had been highly regulated and subject to direct controls for the best part of a decade and with large sections of the population still suffering considerable privations, quick fixes and shock therapy for a return to “normal” market conditions were considered neither economically feasible nor politically acceptable

Looking more carefully at this experience, there are at least seven major virtues of the Marshall Plan which provide useful lessons for thinking about the organization of increased aid to Africa today. *First*, it set a time frame for the post-war adjustment process that was more realistic than that envisaged by the US Treasury. Instead of thinking in terms of 18 months, the time scale was changed to four to five years. The Marshall Plan was actually a belated recognition of the fact that policy makers in the United States, especially in the US Treasury, had been far too optimistic about the time it would take to return to “normality” after the cessation of hostilities. By this was meant the removal of direct controls on national economies and a return to a system of multilateral free trade and payments, in accordance with the rules of the new BWIs which were to provide the basic architecture of the post-war economic system. The attempt

to put these new arrangements into place rapidly, an early example of “shock therapy”, founded in a series of European dollar crises and a sharp economic downturn.

*Second*, Marshall made it clear that there was to be an end to the piecemeal assistance which had suffered from a lack of coordination and had less impact than expected in stimulating economic recovery. A key requirement, therefore, was that each state receiving aid had to produce a four-year outline plan for recovery, setting out targets for the main economic variable and providing an account of how the government intended to achieve its objectives.

*Third*, Marshall insisted that these plans, together with estimates of the need for assistance had to be drawn up by the west Europeans themselves. “It would be neither fitting nor efficacious for [the United States] to undertake to draw up unilaterally a program designed to place Europe on its feet economically. This is the business of the Europeans. The initiative, I think, must come from Europe. The role of this country should consist of friendly aid in the drafting of a European program and of later support of such a program ....”. Marshall thus acknowledged national sensibilities, admitted that the recipient countries were better informed about the facts of their situation than outsiders, and generally showed a deference towards European traditions and preferences that has often been conspicuously absent in the subsequent attitudes of the rich countries and international institutions towards the rest of the world.

A *fourth* feature of the Marshall Plan was that aid was to be released in tranches that depended on the countries’ intermediate targets being met. The removal of the recovery programme from the Bretton Woods framework did not therefore imply an escape from conditionality, but the Marshall Plan conditions were different, more flexible and were to be met over a longer period than allowed by IMF rules.<sup>75</sup>

*Fifth*, the Marshall Plan acknowledged that the damage to European productive capacities and the great disparity in economic strength compared with the United States meant that Europe would gradually dismantle a wide range of direct and indirect controls on its trade according to an agreed timetable within the framework of the European Payments Union between 1950 and 1958. This gradual liberalization of trade provided some protection against American competition and gave time and encouragement for the reconstruction of enterprises potentially capable of producing competitive substitutes for dollar

imports. At the same time, the US agreed to a more rapid improvement in access to its own market for European exports, a policy of asymmetric liberalization that stands in marked contrast to some recent trends which insist on a rapid opening of developing countries’ markets and on restricting the range of policy options available for their development.<sup>76</sup>

Six, effective leadership requires both generosity and a long-term commitment. Marshall Aid consisted largely of grants and the small proportion of loans contained a large element of grant: they were usually for 35 years at 2.5 per cent interest with repayments starting in 1953. It is worth emphasizing this structure of financial help at a time when “aid” and “assistance” are used loosely to cover everything from gifts to loans at market (or above-market) rates of interest. The wisdom of adding to the debts of already heavily indebted economies is highly questionable, the more so when they are grappling with economic restructuring and institution building, which is typically the case for countries trying to accelerate their development or to recover from the chaos that normally follows the end of violent conflict.

Finally, the *seventh* virtue of the Marshall Plan that is relevant to current problems in Africa was its insistence that there should be a degree of united and cooperative effort among the Europeans themselves, and that the plans of the 16 recipient countries and the allocation of aid should be coordinated in a regional body.<sup>77</sup> This requirement partly reflected US foreign policy objectives for a more integrated Europe, but it provided a structure for cooperation in areas where there are significant externalities, economies of scale and other trans-boundary issues. The peer review of national programmes provided national policy makers with a regional perspective for their own policies and encouraged a culture of regular contact and cooperation among national bureaucracies which today is taken for granted in Europe.

On all these counts, there are already some signs that the donor community in its approach to ODA to Africa is going back to Marshall: the switch from structural adjustment to the MDGs suggests a lengthening of the time frame for dealing with aid effectiveness; local ownership has figured prominently in recent debates on how to manage such flows to Africa, including through regional peer review in the context of NEPAD;<sup>78</sup> and doubts about excessive conditionalities have led some countries to consider a more minimalist approach. However, in all these respects the process has so far been ad hoc and the kind of coordination

that Marshall recognized as essential is still missing. For example, NEPAD has not been spared its share of criticisms.<sup>79</sup>

This is not to suggest a simple replication in Africa of the initiatives of 1947, but rather that the *processes* of the Marshall Plan can help to provide a coherent framework for coordinating national economic development plans with international assistance. Without a reasonably articulate account of a government's macroeconomic objectives and their relation to detailed programmes for infrastructure investment, education, health, housing, etc., it is difficult to see how limited supplies of foreign assistance, financial and technical, can be really effective. Official assistance is essentially a form of intervention to ease shortages, bottlenecks and other constraints on growth and structural change, but it is difficult to target aid to where it will be most effective without some idea of priorities and the potential marginal effect of removing one bottleneck, say, before another. Similarly, the impact of assistance will be reduced if complementarities are overlooked: funds for treating the victims of HIV/AIDS and other major diseases, for example, will be diminished if the planning and funding of health support services is neglected or underestimated.

National development programmes along the lines of the Marshall Plan would make it easier to provide general, non-project assistance to government budgets or the balance of payments, as was done for a number of European countries under Marshall Aid. Development (even more than reconstruction) programmes are essentially dealing with deep-rooted structural problems and both fiscal and current account deficits are usually unavoidable if constructive, long-run adjustment is to be achieved. The need to provide financial assistance to deal with long-term imbalances is often, if not usually, seen by the international financial institutions as evidence of a weak commitment to reform and as encouraging a slackening of discipline by postponing necessary adjustment. This was not the view of the Marshall Planners who regarded such assistance as an investment in structural change and as providing governments with the required breathing space to bring difficult and often painful policies to success.

A generous supply of grants, monitored within, and guided by, a coherent economic programme on the lines of the Marshall Plan can be more effective than loans in lifting countries out of a "stagnation trap" where heavy debt-servicing obligations hold back the domestic and foreign investment that could improve the longer run performance of the economy, including its capacity to service debt. Another advantage of grants is that they are not usually subject to

the long and complex negotiations, legal and financial, associated with loans. This is important because one of the lessons of the Marshall Plan is that prompt assistance at the start of a promised programme can help to sustain positive expectations, which most likely will have been raised by politicians, and instigate a momentum for change that will stand a chance of becoming self-reinforcing. Providing grants within a Marshall Plan framework should also go a long way to meeting most of the criticism against them discussed earlier: for example, the problem of fungibility largely arises from the lack of a coherent development programme together with a similarly coherent account of the sources of finance required to support it.

As discussed previously, aid is usually provided with a close eye on the interests of the donor. That is to be expected, but a lot depends on whether donors see their interests narrowly or broadly, short-term or long-term, and whether larger public interests prevail over narrower corporate and national ones. There are public goods aspects to aid if it succeeds in raising the prospects for growth and development and thereby reducing threats to regional and global security, easing the pressures for migration, and so on. Grants may therefore generate a higher rate of return in terms of the donors’ larger interests than loans.

Another major attraction of a Marshall Plan framework is that it can serve an important political function. A multi-year programme of economic and social objectives, setting out their interrelationships, the means to achieve them and their contingency on outside assistance, effectively sets out the government’s vision of the structure of society at which it is aiming. That is highly political, and so the proposed programme provides – or should provide – a basis for the democratic discussion and the negotiation between competing views that is necessary in order to build the social and political consensus for what is essentially a plan for societal transformation. This may not always result in what is conventionally regarded as “best” policies, but the advantage of democratic processes is that they generate pressures to correct mistakes: they may reach the “best” policy more slowly than if driven by outsiders, but politically the slow route may be superior. A “new Marshall Plan” could thus be a way to provide a concrete operational basis for such ideas as “ownership” and “partnership”, which otherwise risk degenerating into empty slogans. Moreover, a coherent national programme with popular support, indicating where outside assistance could be most effective, *ipso facto* becomes a powerful argument for persuading potential donors to respond to national priorities rather than following their own preferences from a basket of seemingly unrelated projects. The emphasis on

*national* programmes is deliberate because the danger in some recent suggestions for a new Marshall Plan for Africa is that they seem to imply that the continent is homogeneous, which is very far from being the case. The approach in Europe in the late 1940s was to treat each country as a specific case but to bring them together in a regional framework of cooperation that would support both national objectives and regional coherence.

### 3. Elements of a new architecture

Accepting that some degree of architectural reform is needed if the doubling of aid to Africa is to be used effectively, the key question is what the specific changes should be. One immediate issue to resolve is the relative roles of bilateral and multilateral aid. Already in the late 1960s, the Pearson Commission (Pearson, 1969) was calling for the multilateral component, which then stood at around 20 per cent to be raised. That call has been echoed some four decades later by the Secretary General of the OECD and the United Nations in 2002, with the clearly stated aim of increasing the current multilateral share to well above its current level of 30 per cent. If, for example, the whole of the additional aid promised to Africa was channelled through multilateral institutions, that figure would rise to around 55 per cent.

With an eye to the strong possibility that geo-politics, linked, for example, to the growing demands on Africa's natural resources, could begin reassert a strong influence on the allocation of aid,<sup>80</sup> there are good grounds for channelling the promised increase in ODA through multilateral arrangements that are less prone to political interference from major shareholders.

The EU has already made a commitment to untie its aid and to tailor it more closely to local needs. At the same time, there is a growing recognition among European parliamentarians and policy makers that the kinds of conditionalities that were attached to loans and grants in the past by the international financial institutions have not been in line with their own sensibilities. On some accounts, the EU's own experience with regional funds offers an alternative option (Abegaz, 2005: 442–444).<sup>81</sup> These funds have a clear focus on strengthening investment (in both the private and public sectors), are packaged in the form of multi-year programmes, have strong local ownership and seek to deal with fungibility

problems through matching funds and additionality principles; they also contain clearly stated aims to strengthen state capacity at the local and central levels.

Perhaps with these concerns in mind, the EU has established a trust fund to disburse some of its own increase in aid to Africa, using for this purpose the European Investment Bank (EIB), the EU’s soft-loan lending arm and “the world’s largest public development bank” (Rogerson et al., 2004: 26). The stated aim of this fund is to provide subsidized, low-interest loans for infrastructure projects, particularly those with a cross-border dimension – a focus that reflects one of the virtues of the Marshall Plan, discussed above. The initial proposal of 60 million euros in grants would be matched by up to 260 million euros in loans from the EIB. This is very much a pilot scheme, but it does appear to express an intention to channel European aid to Africa in a way that avoids the kinds of policy conditionality attached to concessional lending by the World Bank. Questions have been raised by civil society groups about the appropriateness of EIB’s role given its lack of experience with African development. However, this does not seem to be an unsurmountable obstacle and could be effectively addressed through close collaboration with the relevant African institutions and the secondment of appropriately trained staff. Perhaps more seriously, others have pointed out that it is not a multilateral development bank but is rather caught up in the intricacies of institutional overlap between the European Commission and the development programmes of its member states (Rogerson et al., 2004: 27–28).

An alternative means of delivering increased aid to Africa would be a well-designed, grant-based regional development fund under UN auspices. In the light of earlier arguments, such a Fund would be explicitly focused on economic development, with a major responsibility for strengthening the investment-growth nexus across the region. In part, this would build on MDG 8, but there would be a wider mandate to include investment in physical infrastructure, support for sectoral strategies, technological upgrading and urban development. A soft-loan mechanism in the UN, albeit not limited to Africa, was floated in the mid-1950s as the Special United Nations Fund for Development (SUNFED), and despite opposition from some governments, the United Nations Economic and Social Council recommended its establishment. However, a compromise was eventually agreed by the General Assembly which essentially transferred the soft-loan function to the World Bank through the creation of the IDA, while the Special Fund gravitated towards technical assistance and was eventually merged with the UNDP.

Reviving such an arrangement today would have some clear advantages over existing channels. In the first place, it would be designed explicitly to handle additional flows to Africa and could be established with term limits firmly in mind. Moreover, with the CFA's case for frontloading aid well established, such a Fund could provide a focus for further fund raising, including from the various new sources of finance proposed to support development, such as a levy on international air travel, a global lottery and donor borrowing through an International Finance Facility. Marrying such mechanisms to the resources already committed from expanded aid budgets could lead to a very large increase in available funds. In this respect, it is worth noting that IDA currently makes annual net disbursements of around \$5 billion, of which 40 per cent go to Africa. With a total replenishment of some \$5.4 billion for its present ADF-X cycle, 2005–2007, the AfDB will be providing about \$1.8 billion annually through this soft window. However, only about 18–21 per cent of both the IDA and ADF funding were to be in the form of grants during the last IDA and ADF-IX cycles, and their rates of disbursement tended to be slow. Indeed, grants made up only 19.5 per cent of the ADF-IX disbursements, although the share of grants in the overall replenishment of ADF-X is expected to increase significantly to 34.3 per cent with as many as 21 ADF-only countries receiving assistance entirely in grants (AfDB, 2004:35; 2005).

As a first step, it might be advisable to transfer IDA's funds dedicated to Africa to the new Fund in order to ensure maximum impact. It should also be possible to merge this new Fund with the ADF, with disbursements being governed by more efficient and rapid administrative procedures that would evolve within the context of the new Fund. The final status of the new Fund (whether it should be absorbed into the AfDB or continue its independent existence) should be discussed within a flexible and innovative framework that incorporates all stakeholders.

One argument in favour of a greater role for multilateral economic institutions is that they are superior to private agents in generating and disseminating sound policy advice and related technical assistance. Such institutions possess considerable research and practical experience, as well as having access to information in the developing countries themselves. They are also positioned to get policies implemented through a combination of pressure and persuasion, including through conditionalities, and to monitor the outcomes. As has already been noted, the argument that aid works in conjunction with the right policies has underpinned the case for channelling aid through existing multilateral institutions



such as the World Bank. However, there are unresolved questions about the governance structure of the IFIs regarding such matters as representation and ownership, accountability and transparency, all of which have a direct bearing on the effectiveness of aid, and which have been the subject of frank debate since the late 1990s.<sup>82</sup>

The principal advantage of attaching such a Fund to the United Nations would be to escape from ideological biases and political pressures in determining what are the “right” set of policies to get aid working. There is evidence that SAPs have not had the desired outcome in terms of growth performance and poverty reduction. More recently attention has turned to assessing whether the PRSP process offers more hope. In an earlier report on Economic Development in Africa (UNCTAD, 2002), the UNCTAD secretariat concluded:

- there was tension between ownership and conditionality;
- the PRSPs had not replaced the development strategies implemented under SAPs and were continuing to endorse the very stabilization policies and structural reforms that have failed to stimulate growth and to reduce poverty across the region;
- despite recognition of the possible negative impact of these policies on the poor, there had been no attempt to provide the kind of social impact analysis that would be needed to determine the kind of measures required to mitigate such adverse effects;
- there was a lop-sided emphasis on the social as opposed to the productive infrastructure and a greater emphasis on market opening than on structural change;
- despite an emphasis on ownership and local participation, and while recipient governments had freedom of action in devising social safety nets, the determination of the nature and content of macroeconomic stabilization and adjustment programmes, and of development strategies more generally, continued to be severely constrained.

In a series of recent reports, the World Bank has acknowledged some of these weaknesses (World Bank, 2005c and 2005d). Doing so goes a long way to recognizing that the Washington institutions do not have a monopoly on technical competence and that a wealth of expertise exists elsewhere including in the UN system and among local policy makers. The fact of the matter is that the understanding of the causes of economic growth and of the ways in which

it interacts with social and political variables is still very limited and there is no monopoly of the truth.

There is general agreement that capital accumulation plays a crucial role in the development process and that, linked to structural and technological change, cumulative dynamic processes can be unleashed that can help to sustain a steady increase in productivity (and incomes) to levels that break through the various poverty traps. The general uncertainty about the precise sources of progress, and the various ways in which they combine in different countries and conditions, points to the necessity for careful experimentation with institutions and policies in order to discover what will be effective in any particular national context where history, culture and existing conditions all have a considerable influence on the possibilities for growth and development. Given the premium on flexibility and “adaptive efficiency”, and given also the absence of universal laws of economic growth, restricting the policy space available to African countries is more than likely to be counterproductive. It is certainly unacceptable, *a priori*, to rule out certain policy instruments, or to make aid contingent on a singular vision of how the economy is believed to work. Given these considerations, a new Development Fund for Africa would need to be supported by an independent, professional secretariat which would be protected from political interference by donors and which should be guided in its work by generally accepted principles for an international secretariat.<sup>83</sup>

For most countries, many of their pressing everyday economic problems invariably involve their neighbours. This was certainly recognized in the original Marshall Plan and is particularly true of Africa today. Regional cooperation to lower trade barriers and other obstacles to doing business within the region can provide larger markets for small, low-income countries, making it easier for them, if it suits their development strategies, to attract FDI, and to provide harmonized rules for dealing with international firms (UNCTAD, 2005a). For small, fragmented economies, infant-industry policies may also be more effective in a regional than a small national market and infrastructure provision may also best be handled in a regional context. The very fact of increased efforts at such cooperation is itself a sign of increasing stability and security in a region and that can be an important influence on economic activity in general and fixed investment in particular.<sup>84</sup> The practical consequence, however, is the gradual evolution of a form of regional or international governance as countries seek ways to reconcile their pursuit of national objectives with international constraints, an activity based on local knowledge that can also contribute to developing the

autonomous learning capabilities that Joseph Stiglitz, among others, identifies as crucial for promoting both development and democracy (Chang, 2001). This suggests that the necessity and benefits of collective action, on the one hand, and the evident desire of peoples to preserve as far as possible their autonomy to decide national policy, on the other, can be balanced in many areas without the need for over-arching global bodies. The European experience points to the valuable role that can be played by effective regional institutions staffed by competent and independent secretariats and headed by imaginative and energetic leaders.

## 4. Some unresolved architectural details

The basic argument for reforming the existing international arrangements for handling aid is to avoid duplication and fragmentation and achieve a much better coordination both among the various donors and in relation to development programmes in the receiving countries. Arguably the onus is on the larger donor countries to take a lead. But, by implication, smaller donors should also channel more of their aid through multilateral institutions with good and well-developed delivery systems. The problems with such a proposal are that many small donors have a strong developmental record and, especially, that relatively new bilateral agencies continue to see aid as a way of asserting their own national influence on the international public arena and hence are unwilling to channel their assistance via multilateral bodies. Overcoming such resistance is obviously important if aid is to be more effective. Much will also depend on the quality and integrity of the secretariats of the multilateral bodies, the transparency and governance of their operations, and their ability to establish effective lines of communication with African policy makers.

Any proposal to establish a new aid facility for Africa also needs to address relations with existing arrangements. In the case of Africa, there is, of course, a well-established multilateral framework with the AfDB, UNDP, ECA and the African Union (AU) providing the backbone of the system. The proposal made here leaves that in place. The need to strengthen short-term financing to deal with trade and financial shocks is generally accepted and the BWIs have the structures and the expertise to respond to these concerns. Moreover, there are strong arguments for a strengthened AfDB to enhance its responsibility for medium to longer-term development financing once the current round of aid

commitments begins to level off, to continue to strengthen its field presence and to find ways of making it less vulnerable to replenishment discussions from non-regional members. In principle, a stronger role can also be envisaged for the AU in providing a collaborative structure within which a strong regional focus could be developed. Moreover, given the explicit time frame envisaged for the aid initiative, secondment of staff from these organizations is likely to be the most sensible way of developing the technical competence and sensitivities which will be required by an independent secretariat if it is to manage the promised resources most effectively.

There are several relatively new aid organizations such as the Investment Climate Facility for Africa (ICF), the Global Fund and the Millennium Challenge Account that need to be accommodated in any discussion of a future architecture. Only the first of these has the kind of regional profile that is proposed in this report, but none are operating on a scale consistent with the demands of a big push model of development. The ICF is a public-private partnership with an initial capital of \$10 million that it hopes to augment with contributions of some \$120 million from the private sector in its first three years. In most cases, bilateral donors do not seem to have worked out how they will react and adjust to these initiatives. For example, thematic organizations such as the Global Fund focus on global public goods and do not necessarily deliver aid in accordance with the development priorities of the recipient countries.

Since the 2005 World Trade Organization Ministerial Meeting in Hong Kong, "Aid for Trade" has gained prominence in the international aid discourse. While the idea is still in its infancy, there are grounds for hoping that, if pursued on an appropriate scale, if additional to the already promised increases of aid, and if geared to diversifying the economic base of the countries concerned through accompanying trade and industrial policy, the initiative could have the desired developmental impact. This might mean substantially delinking the initiative from the context of the Doha negotiations, and instead connecting it to the ideas of a "big push" and Marshall planning, as outlined in this report.

With the increasing incidence of HIV, avian flu, terrorism, narcotics and migration perceived as growing threats, it is possible that the future architecture of aid will be influenced by a proliferation of organizations focused on such public externalities and by the mobilization of resources in the North in ways that could fundamentally change the aid landscape.<sup>85</sup> In principle, these activities should be

kept separate from the more specific economic developmental challenges that have been discussed in this report.

Another issue concerns the role that NGOs and civil society will play in any future architecture. As noted earlier, these have proliferated rapidly in recent years. At one level, they are part of a vital information-gathering and monitoring network that might be better placed to tailor aid to micro conditions, particularly with respect to social goals. At another level, however, they could have a negative impact on efforts to establish state capacities: as *The Economist* (2005) graphically put it, there is a real danger that these institutions might “cannibalize the state institutions on which any country must ultimately depend”. Clearly a balance has to be struck, but that should be the responsibility of policy makers in the recipient countries. Certainly, increased aid for budget support, as advocated by many donors, and also in this report, combined with the increased size of government required to handle a doubling of aid, implies a need for greater clarity about their role in aid delivery and in their interaction at the country level.

At present there appears to be no permanent multilateral forum in which the issues raised in this report, whether concerning bilateral versus multilateral aid, grants versus loans, global public goods versus development assistance, ownership versus conditionality, the role of civil society, etc. are being rigorously addressed from the perspective of the potential recipients. The OECD’s DAC, of course, is an important venue, but one that is very much focused on donor concerns and challenges. This institutional hiatus must be a matter of concern if aid is to double in the near future and if the chaos of an unregulated aid market is to be avoided. One suggestion is that there should be an aid ombudsman, perhaps located in the UN, who would monitor commitments and hold donors to account on internationally agreed, time-specific targets (ActionAid, 2005). Something similar has been suggested in the context of the CFA. However, this is still too narrowly focused. An alternative could be for UNCTAD, an institution which was in the vanguard of the early aid debates that established the 0.7 per cent aid target and more recently revived the case for doubling aid to Africa, to provide such a forum by creating a Commission on Aid and Development. This could combine in-house experience with outside expertise, work on the consensus-building principle, and provide a forum open to civil society groups for frank, well-informed and constructive debate on the issues raised in this report.<sup>86</sup>

**Appendix Table**  
**SUB-SAHARAN AFRICA: AID FROM ALL DONORS AS A RATIO OF GDP, 2004 AND PROJECTIONS FOR 2015 AND 2020**  
 (Million US dollars)

	2004		2015		2020		2004		2015		2020	
	Aid	GDP (current US dollars)	Doubled 2004 Aid	Projected GDP*		Aid to GDP	Aid to GDP* ratio after doubling of 2004 aid		Percentages		2%	6%
				2%	6%		2%	6%	2%	6%		
	Million US dollars											
Liberia	577	492	1155	612	934	676	1250	117.3	188.7	123.6	170.9	92.4
Sao Tomé & Príncipe	33	62	67	77	118	85	158	53.7	86.4	56.6	78.2	42.3
Burundi	343	657	687	817	1248	902	1669	52.3	84.0	55.1	76.1	41.1
Sierra Leone	359	1075	718	1337	2042	1476	2732	33.4	53.7	35.2	48.6	26.3
Eritrea	280	925	519	1150	1755	1269	2349	28.1	45.1	29.2	40.9	22.1
Guinea-Bissau	78	280	155	348	532	385	712	27.7	44.6	29.2	40.4	21.8
Madagascar	1195	4364	2389	5426	8284	5991	11086	27.4	44.0	28.8	39.9	21.6
Congo Dem.Rep.	1795	6628	3590	8241	12581	9098	16837	27.1	43.6	28.5	39.5	21.3
Malawi	477	1879	954	2337	3567	2580	4774	25.4	40.8	26.8	37.0	20.0
Rwanda	468	1845	937	2294	3502	2533	4687	25.4	40.8	26.7	37.0	20.0
Mozambique	1328	6086	2657	7567	11553	8354	15460	21.8	35.1	23.0	31.8	17.2
Ethiopia	1719	8003	3439	9951	15193	10987	20331	21.5	34.6	22.6	31.3	16.9
Zambia	1120	5402	2241	6716	10254	7415	13722	20.7	33.4	21.9	30.2	16.3
Niger	559	3081	1118	3831	5849	4230	7828	18.1	29.2	19.1	26.4	14.3
Uganda	1154	6822	2309	8483	12951	9365	17331	16.9	27.2	17.8	24.6	13.3
Tanzania	1657	10851	3313	13492	20599	14896	27566	15.3	24.6	16.1	22.2	12.0
Gambia	63	415	126	516	788	570	1054	15.1	24.4	16.0	22.1	11.9
Cape Verde	140	948	280	1179	1800	1302	2409	14.7	23.7	15.5	21.5	11.6
Ghana	1207	8869	2414	11028	16837	12176	22531	13.6	21.9	14.3	19.8	10.7
Senegal	1057	7775	2114	9668	14760	10674	19752	13.6	21.9	14.3	19.8	10.7
Mauretania	201	1534	402	1907	2912	2106	3897	13.1	21.1	13.8	19.1	10.3
Burkina Faso	609	4824	1217	5998	9157	6622	12254	12.6	20.3	13.3	18.4	9.9
Mali	558	4863	1116	6046	9231	6676	12353	11.5	18.5	12.1	16.7	9.0
Djibouti	64	663	128	824	1259	910	1685	9.7	15.6	10.2	14.1	7.6
Somalia	191	2088	383	2596	3964	2866	5304	9.2	14.7	9.7	13.3	7.2
Benin	370	4075	739	5067	7736	5594	10352	9.1	14.6	9.6	13.2	7.1
Central African Rep.	105	1307	209	1626	2482	1795	3321	8.0	12.9	8.4	11.6	6.3
Chad	324	4221	649	5248	8013	5795	10723	7.7	12.4	8.1	11.2	6.0
Lesotho	95	1312	198	1632	2492	1802	3334	6.5	12.1	7.9	11.0	5.9
Comoros	25	367	49	456	696	503	931	6.7	10.8	7.0	9.7	5.3
Guinea	235	3870	471	4811	7346	5312	9830	6.1	9.8	6.4	8.9	4.8
Swaziland	145	2396	289	2979	4549	3289	6087	6.0	9.7	6.4	8.8	4.8

## Appendix Table (contd.)

Sub-Saharan Africa	24921	523310	49842	650670	993399	718393	1329392	4.8	7.7	5.0	6.9	3.7
Sudan	878	21098	1756	26232	40050	28963	53596	4.2	6.7	4.4	6.1	3.3
Zimbabwe	186	4696	373	5839	8914	6446	11929	4.0	6.4	4.2	5.8	3.1
Kenya	622	16088	1244	20003	30539	22085	40868	3.9	6.2	4.1	5.6	3.0
Togo	71	2061	141	2563	3912	2829	5236	3.4	5.5	3.6	5.0	2.7
Cameroon	457	14391	913	17893	27318	19755	36557	3.2	5.1	3.3	4.6	2.5
Namibia	160	5712	320	7102	10844	7842	14511	2.8	4.5	2.9	4.1	2.2
Angola	398	19493	796	24237	37003	26759	49518	2.0	3.3	2.2	3.0	1.6
Seychelles	8	704	15	875	1335	966	1787	1.1	1.8	1.1	1.6	0.9
Nigeria	729	72053	1458	89589	136779	98914	183041	1.0	1.6	1.1	1.5	0.8
Equatorial Guinea	30	3235	59	4022	6141	4441	8218	0.9	1.5	1.0	1.3	0.7
Gabon	58	7229	116	8988	13722	9923	18363	0.8	1.3	0.8	1.2	0.6
Congo, Rep.	30	4343	61	5400	8244	5962	11033	0.7	1.1	0.7	1.0	0.6
Cote d'Ivoire	72	15475	144	19241	29375	21243	39311	0.5	0.7	0.5	0.7	0.4
Mauritius	28	6034	56	7503	11455	8284	15329	0.3	0.7	0.5	0.7	0.4
Botswana	27	8974	53	11158	17035	12319	22797	0.3	0.5	0.3	0.4	0.2

Source: UNCTAD secretariat computations based on OECD and World Bank online databases.

Note:

Aid includes net official development assistance (ODA) and other official flows (OOF).

ODA net consists of bilateral grants and bilateral loans.

\* Projected GDP growth of 6% is the minimum rate assumed to be necessary to achieve the MDGs.

The rate of 2% represents a worse-case scenario.

\*\* Countries ranked by their aid to GDP ratio in 2004.

## Endnotes

- 1 US aid can be traced to Latin American countries in the 1930s and 1940s – under the “Good Neighbourly Policy” of the Roosevelt Administration – and sometimes as far back as the 19<sup>th</sup> century (Hjertholm and White, 2000; Kanbur, 2003; Hudson, 2006 and Hjertholm et al., 1998).
- 2 The assumption is that in an open economy, savings finance investment with the total savings in the economy comprising domestic and foreign savings. A savings gap exists if domestic resources are much less than what is required to fund the investment necessary to attain a target rate of growth. Similarly, if there is insufficient foreign exchange (i.e. insufficient exports) to pay for imported goods, which must complement domestically produced investment goods in order to attain a target growth rate, a “trade gap” or “foreign exchange gap” is identified (Rosenstein-Rodan, 1961).
- 3 The share of these two countries in total DAC flows to Africa was 50 per cent (1960–1969) and 28 per cent (1980–2004). Africa has never ranked high in US geo-strategic calculations, and in the 1990s received just about 10 per cent of US aid (CBO, 1997), although that may be about to change in view of the new emphasis of the US on energy security, which seeks to diversify its energy sources away from the Middle East.
- 4 In Africa, the Democratic Republic of Congo (the former Zaire) was a major aid recipient during much of the Mobutu period, partly due to the strategic interests of major donors, and partly due to IMF and World Bank anxiety to avoid the consequences of default on their debt (Lancaster, 1999: 1).
- 5 The former Director of USAID, for example, argues that the principal reason for the decline in ODA during the 1990s was the absence of a clearly understood threat to Western interests which foreign aid could remedy (Natsios, 2006: 132).
- 6 This was of course the case in post-war Europe (Marshall Plan) and during the Cold War (Alliance for Progress) and there were reductions in aid during periods of “détente” or of perceived decline in security threats, as in the immediate aftermath of the fall of the Berlin Wall (Natsios, 2006: 132). When USAID was created in 1961, its mission in the words of President Kennedy was “to prevent the social injustice and economic chaos upon which subversion and revolt feed” (Bate, 2006: 114).
- 7 The 1977 document, the first such policy document in a little over two decades (since 1975) by the UK Government, is titled “Eliminating World Poverty: A Challenge for the 21<sup>st</sup> Century”, while the 2000 paper has the title “Eliminating World Poverty: Making Globalisation Work for the Poor”.
- 8 SSA has always had a higher share of global multilateral flows than bilateral flows, a share that rose steadily from a little over a quarter in the mid-1970s to a peak of 45 per cent in the late 1980s.
- 9 The high per capita flows to these countries during 1990–1999 is due to very large inflows of multilateral aid, ranging from \$5 billion to \$6 billion, to South Korea during the Asian financial crisis, 1997–1999.
- 10 On FDI volatility and concentration, see UNCTAD’s 2005 report on Economic Development in Africa, in particular tables 2 and 3 (UNCTAD, 2005a).



- 11 The Committee of Experts of the African Ministers of Finance and Planning in 2004, while applauding the heightened priority under the HIPC initiative to invest in social sectors, noted with concern the sharp reduction in the share of aid going to the productive sectors and cautioned African governments not to neglect investments in productive sectors.
- 12 See box 1 for a definition of “phantom aid”.
- 13 The cost of a foreign expert is a multiple of the cost of a similarly qualified local person. ActionAid (2005) estimates that DFID paid foreign experts between \$18,000 and \$27,000 per month, compared with \$1,500 to \$3,000 for local experts in Viet Nam. In spite of increases in educational achievement among Africans, the amount of aid dedicated to technical assistance has remained high (Sender, 1999: 99–100).
- 14 A significant part of technical assistance comes embedded in a project and the recipient has no choice but to accept it. Additionally, the technical assistance is usually provided with equipment, vehicles and other “accessories” that provide incentives for government departments to accept technical assistance they do not really need. Usually, the recipient would have no role in the selection process and although there is pressure to open up the tendering process, technical assistance usually comes from the donor countries. For examples, see ActionAid (2005).
- 15 Whether or not this merits the epithet of phantom, there is little doubt that it is unlikely to deliver the development impact that is needed for much of Africa.
- 16 Two broad methodologies have been used in estimating the resource needs for attaining the MDGs. One is based on global costing exercises with global elasticities and an average cost guide, the other is based on country-level estimates from which global level requirements are extrapolated. Neither effectively incorporates the multi-sectoral dimension, which is addressed by two well-known studies: the Report by the High-Level Panel on Financing for Development (known as the Zedillo Report (Zedillo et al., 2001)) and a World Bank study by Devarajan et al. (2002).
- 17 One approach estimates the MDG resource needs by calculating the required economic growth rates of countries, and in turn the investment required to achieve them, while the second separately estimates the costs of achieving the individual goals.
- 18 The underlying logic was based on recently minted theories of economic growth developed, it should be noted, with the policy challenges of advanced countries in mind. A United Nations group of experts, as early as 1951, used the Harrod-Domar model to estimate the capital requirement of “underdeveloped countries” to raise national income per capita by 2 per cent annually. Setting more ambitious growth targets and including a more visible structural component to economic development broadened the idea of constraints on growth, including not just a savings or foreign exchange gap, but also a skills and entrepreneurship gap, a fiscal gap, a technology gap and more generally an absence of linkages across and within economic sectors.
- 19 The second UNCTAD Conference in 1968 set a target of 0.75 per cent for ODA which was lowered to 0.7 per cent following work by the Committee for Development Planning on the size of external resources needed to meet a 6 per cent growth target. In 1969, the Commission on International Development convened by the World Bank also argued for a 0.7 per cent target to be reached by 1975. This target was

officially endorsed at the third UNCTAD Conference in Santiago in 1972. However, this commitment coincided with a more fractured debate on aid effectiveness, with poverty, basic needs and human capital attracting increasing attention from donors, while an ambitious agenda of modernization and a new international economic order was capturing that of recipient countries.

- 20 It is not possible to do justice in this Report to the richness of the debates on industrialization in the early development literature. For a useful introduction and guide to the earlier debates, see Toner (1999). In recent years, and with particular reference to East Asian development, UNCTAD's *Trade and Development Report* has attempted to extend these arguments. Needless to say, the attempt by conventional economists to reduce all the issues to polarized questions of inward versus outward oriented development strategies, markets versus planning, etc. is a misleading caricature.
- 21 Milton Friedman (1958) was among the first to canvass such outcomes. Bauer (1966) was a more relentless critic of aid effectiveness. Griffin (1970) provided an empirical warning on crowding out. An early criticism, on both methodological and empirical grounds, was provided by Papanek (1973).
- 22 In the early 1970s, such concerns gave rise to the "basic needs" approach to development policy which had a considerable influence on aid at that time. In the 1980s, the concern that aid was contributing to distorted relative prices that failed to reflect underlying economic scarcities evolved into the call to "get prices right", which became the basis of the "Washington Consensus".
- 23 For a comparison between ODA and other capital flows, see Morrissey and Osei (2004) and UNCTAD (2000a) and (2005b).
- 24 Geo-political aid in this study is proxied on the basis of past and present geo-political ties (as reflected by colonial relationships, a shared language, and common membership in an entente, alliance or agreement).
- 25 It should be noted, however, that many African countries were unable to initiate a process of self-sustained growth even when external conditions were favourable, particularly during the 1970s (UNCTAD, 1998).
- 26 On this "profit-investment nexus", see UNCTAD (1994, 1997 and 2003).
- 27 Krugman (1994:52–57) gives a simple rendition of the model. It should be noted that these models reflect only a part of the potential dynamics linked to industrial dynamism, which also include economies of specialization, plant size, rent creation and linkage effects; for a more extensive discussion, see Ros (2000).
- 28 On the similarities and differences between the older development trap models and poverty trap arguments, see Ros (2000:102–110).
- 29 For more on this argument, see UNCTAD (2006). Some analysts have seen this as a neglected aspect of the East Asian experience (UNCTAD, 1997; Gabre-Madhin and Johnston, 1999; Karshenas, 2000 and Grabowski, 2003). Others have also pointed to its ongoing importance in the newer East Asian growth dragons such as China, Indonesia and Viet Nam (Timmer, 2005). There is also an extensive literature on the economics and policy implications of inter-sectoral linkages going back to the 1960s. For its relevance to current African conditions, see Mellor (2000), Tiffen (2003) and Blunch and Verner (1999).

- 30 This report has in mind a slightly different interpretation of the big push story from those already mentioned, building more on the endogenous growth literature which focuses on supply spillovers linked to technological externalities and investments in human capital. Lucas (1990) offered a seminal model of continuous human capital accumulation generating steady increases in productivity which offset otherwise diminishing returns; Romer (1992) gave a slightly different interpretation by adding a knowledge-producing sector which is not subject to diminishing returns. These are usually referred to as endogenous growth models because technological progress is part of the growth dynamic rather than an exogenous impulse.
- 31 Consequently, its relevance to the role of aid in immediate post-conflict situations may be more limited.
- 32 See van Arkadie (1995) and Mkandawire (2001).
- 33 See Easterly (2005), Rodrik (2006) and Mkandawire (2006).
- 34 This is the lesson drawn by more careful observers of African development experience (Lancaster, 1999).
- 35 Aid absorption is defined as the extent to which a country's current account deficit excluding aid widens in response to an increase in aid and depends on domestic sterilization measures; aid spending is defined as the widening of the fiscal deficit whether through increased expenditure or reduced taxation.
- 36 For a fuller explanation of the causes of the Dutch Disease, see Foster and Keith (2003). The problem is akin to the natural resource curse which has provoked a good deal of controversy among economists. As discussed in UNCTAD (2005b,) there has been a tendency to exaggerate this threat.
- 37 This is not to suggest that there have never been problems in African countries with managing aid. Younger's study of Ghana (Younger, 1992) suggests that Ghana had trouble managing its real exchange rate during the 1980s and early 1990s when the country was a favourite of the aid donors. There was a similar problem in Uganda in the late 1990s (Kitabire, 2005). In contrast, Nyoni (1998) found that aid to United Republic of Tanzania was accompanied by a real depreciation of the currency. IMF (2005) examines cases of aid surges in Ethiopia, Ghana, Mozambique, Uganda and United Republic of Tanzania between 2000 and 2004, finding varied patterns of spending and absorption but few signs of the Dutch Disease problem. For a comprehensive discussion of the links between aid and exchange rate management in Africa, see Buffie et al. (2004).
- 38 On average, actual delivery of aid falls short of commitments by more than 40 per cent, especially in the poorest countries, increasing to more than 50 per cent, the highest level commitment-to-disbursement ratio for 20 years, during the period 1999–2001 (Bulir and Hamann, 2005: 10). The previously cited UNDP Report found that in 47 of 129 countries examined between 2001 and 2003, disbursements fell short of commitments by more than 1 per cent of GNI during one of the three years.
- 39 See section 1 above. The previously cited study of aid flows to 76 countries between 1975 and 2003, half of which were in Africa, prepared for the IMF confirms that aid has been more volatile than domestic revenue and has been increasing in recent years, remained unpredictable and did not act as a buffer against GDP shocks. As

- a proportion of GDP, and in constant US dollar terms, the study found that average volatility is about 40 and 20 times respectively higher than that of revenue; and in terms of median values, 23 and six times, Bulir and Hamann (2005: 7).
- 40 The problem of fungibility and related issues can probably be handled quite well in the sort of Marshall Plan framework that is discussed later in section E.
  - 41 This view of rent-seeking in the development process is criticized in Kahn and Jomo (2002).
  - 42 Moral hazard is the name given to the increased risk of destructive behavior, and thus a negative outcome (“hazard”), because the person who caused the problem doesn’t suffer the full (or any) consequences.
  - 43 See, for example, Killick, 1998; Easterly, 2002; White and Dijkstra, 2003; and Kanbur, 2000.
  - 44 A pilot scheme for handling the most difficult coordination problems in fragile states is already running in nine countries (five in Africa) with some signs of success (World Bank, 2006: 83–84).
  - 45 Evidence collected by the World Bank suggests that low-income countries with weak institutions receive 40 per cent less aid than predicted on the basis of measures of institutional quality, cited in UNDP (2005: 92).
  - 46 This does not rule out efforts by donors who are contemplating increases in aid to determine whether past aid has been associated with declining tax performance and, if so, to ensure that part of the aid budget is used for tax reform.
  - 47 See UNECA (2004).
  - 48 This was a point made a long time ago by Myrdal (1970: 357–448) and more recently by Milanovic (2006). Recent statements by John Githongo, Kenya’s top anti-corruption official who resigned in February 2005 and fled to the UK, demonstrates the extent of continuing corruption (The Guardian, 2006) in the country by senior government officials, and despite the Government’s commitment to an anti-corruption platform. On the other hand, Nigeria’s efforts to fight serious corruption, even at the highest levels of government, shows that with political will, and even where corruption has been deep-rooted and rampant, effectual reforms are quite feasible (The Guardian, 2006).
  - 49 Burnside and Dollar (2000) included an aid-squared term in their model and found that negative returns to aid set in once it reaches 4 per cent of the recipient’s GDP – that is, the saturation point at which the positive impact of aid falls to zero. Similar work by Foster and Keith (2003), however, found that negative returns do not set in until aid reaches 20 per cent of recipients’ GDP, whilst Lensink and White (2001) put the ratio at 50 per cent. Other studies put the saturation point at between 14 and 27 per cent of national income, or about 16–18 per cent of GDP (Gupta, Powell and Yang, 2006: 24). White has argued that the finding of negative rather than diminishing returns is based on relatively few observations and that the econometric evidence is “... neither terribly persuasive nor capable of showing negative returns for the vast majority of recipients, even if aid were doubled” (White, 2005: 9). The IMF also notes that despite the frequent discussion of the challenges of increasing aid, systematic analysis of country experiences is limited and that most existing research, based on cross-country and panel regression analysis, is too limited for policy purposes, particularly

with respect to the effects of increasing aid (IMF, 2005: 7).

- 50 Corruption is, of course, sector specific, with the extractive industries a major focus, linked in many cases to attracting FDI. Within public services, the health sector has been identified as particularly vulnerable (All Party Parliamentary Group, 2006:17–19). The defence sector is another notorious breeding ground for corruption, and not just in developing countries. Despite its very small share of total world trade, the arms trade is reckoned to account for almost half of all the corruption linked to legal trade. See Roeber (2005: 52–56).
- 51 On this problem, see Saasa (2005) and Conyers and Mellors (2005). There does seem to be a trade-off between the poaching of local staff and disbursement rates. A recent study by USAID of nine donor countries found that typically only a fraction of committed resources are disbursed each year and that there was a positive relationship between disbursement of aid funds and decentralization. Those agencies with the most delegated decision-making, measured by the proportion of staff in the field, had the highest disbursement rates (75–87 per cent) whilst those with most staff in headquarters had the lowest (7–12 per cent) (Natsios 2006). Yet decentralization often involves employing large numbers of high calibre local people in country offices who might otherwise be available to the local bureaucracy. This dilemma clearly needs to be resolved if the doubling of aid is to be disbursed in a manner that does not undermine local administration.
- 52 This is notably true of a number of successful East Asian countries, including the more resource dependent second-tier. For discussion of what it might mean to take lessons from these experiences, see the various articles in Akyüz, ed. (1999).
- 53 DAC statistics on NGO activity suffer from incomplete coverage. However, contributions by NGOs from their own resources has been estimated in 2004 at \$7–9 billion; contributions by governments to NGOs at \$1 billion, and government funds channelled through NGOs at \$1 billion (although this is seen as a significant underestimate) (Rogerson et al., 2004: 5).
- 54 All the agencies created since 1945 still exist (Klein and Harford, 2005: 11).
- 55 See Neumayer (2003).
- 56 These are the same countries with the lowest shares of “phantom aid” in total aid on the calculations made by ActionAid in its annual aid report.
- 57 On this point and its troubling consequences, see Kaul (1999) and Raffer (1999).
- 58 On the role of international taxation for funding global public goods in a new global governance system, see Van der Hoeven (2001) and AFD (2005): 25–27.
- 59 A cross border externality occurs when an action in one country spills over to other countries with consequences that are not properly priced by market forces. A public good is defined as one whose consumption by one individual does not exclude others (non-rival) and whose benefits cannot be denied to others (non-excludable). Such goods are not adequately supplied through markets because of free-rider problems.
- 60 The Meltzer Commission, established earlier by the United States Congress to examine the governance of the international financial system, had also recommended that loans to the poorest countries be converted to “performance-based” grants.

- 61 This excludes two other countries classified as Category B countries; that is, those eligible for concessional and non-concessional financing.
- 62 For a helpful discussion of the role of multilateral development banks in the light of the ongoing discussions on ODA, see UN (2005a:122–124).
- 63 Clements et al. (2004) found that an increase in grants tends to suppress domestic tax revenue, especially in the most corrupt quartile of countries where 95 per cent of grants were immediately dispersed in the form of tax cuts. In contrast, loans encouraged revenue raising. Likewise, Odedokun (2004) found that grants either reduce the tax effort or encourage deficit financing as well as encouraging government consumption rather than investment.
- 64 In this study, by contrast, loans appear negatively associated with growth.
- 65 For a discussion of the pros and cons of some of these proposals, see Addison et al. (2005).
- 66 USAID, for example, is much more sceptical of budget support. In the words of its former Director: “For the moment I would like to question general budget support, on the ground of its “purity” or universal effectiveness... Of all implementing mechanisms, general budget support is also most vulnerable to diversion, and may impede reform by strengthening the bureaucratic status quo” (Natsios 2006: 135).
- 67 For an assessment of the pros and cons of the sector-wide approach in the Zambian health sector, see Kanbur and Sandler (1999). See also Foster and Keith (2003) on the Ethiopian experience.
- 68 On the nature and history of conditionality, see Buira (2003).
- 69 See Easterly (2002), Barro and Lee (2002) and Vreeland (2003) for the evidence.
- 70 Horst Köhler on becoming the new Managing Director of the IMF noted in his address to the Board of Governors in Prague in 2000: “I trust ownership is promoted when the Fund’s conditionality focuses in content and timing predominantly on what is crucial for the achievement of macroeconomic stability and growth. Less can be more if it helps to break the ground for sustained process adjustment and growth”.
- 71 See Eyben (2005). For useful criticisms of the Burnside and Dollar analysis, see Kanbur (2003) and Amprou et al. (2006).
- 72 “... Unlike the Cold War, we are now menaced more by ‘fragile states than by conquering states’ as President Bush’s National Security Strategy 2002 declares” (Natsios, 2006: 131–132).
- 73 This proposal has been strongly articulated by former World Bank economist Bill Easterly. See Easterly (2002 and 2006), also Klein and Harford (2005) and Bhagwati (2006) for similar sentiments. The last of these is much more forceful in insisting that aid should be driven by acts of private charity. For a short but powerful critique of Easterly’s analysis, see Sen (2006).
- 74 The UN’s Economic Commission for Europe seems to have started the fashion in early 1990 when it argued the need for a programme on the scale and in the style of the Marshall Plan to assist the countries of Eastern Europe in their transition from centrally planned to market economies (UNECE, 1990). This was taken up by Chancellor Helmut Kohl and his Foreign Minister, Hans-Dietrich Genscher, who called for a Marshall Plan

for Russia in 1992. In 1997, the then EC President, Jacques Santer, described the programme and costs of EU enlargement as “a veritable Marshall Plan” for Eastern Europe. In April 1999, Prime Minister Tony Blair called for a “Marshall Plan” for the Balkans and in October 2001, the Italian Prime Minister, Silvio Berlusconi, proposed one for solving the economic problems of the Palestinians on the West Bank.

- 75 Conditionality was important not simply to ensure that the aid was being used effectively but also to gain, and sustain, the support of the American taxpayer.
- 76 Another, largely forgotten, aspect of American restraint towards the relative economic weakness of Europe in 1947 was a moratorium on foreign investment in Germany until monetary equilibrium had been more or less achieved (Kindleberger, 1989). The prospect of US capitalists buying up Mercedes, Siemens and other major plants at knock-down prices did not appear to the State Department as a useful contribution to winning the “hearts and minds” of a defeated population and a future ally. For economists involved in the Marshall Plan, such as Charles Kindleberger, this was a sensible policy based on the theory of second best, namely, that when markets fail to work, or do not exist, they should not be used. Instead, the priority should be to create or re-build the institutional framework that will ensure they will eventually work efficiently.
- 77 This was the Organization for European Economic Cooperation, founded in April 1948, and which was later converted into the more permanent OECD.
- 78 Peer reviews and the regular exchange of information about national plans and programmes can help to avoid or lessen the problem of too many countries diversifying into the same product groups, the problem of the “fallacy of composition”, as discussed in previous Africa reports.
- 79 For example, NEPAD has not been spared its share of criticisms. It has been criticized as having little enforcement power, unclear responsibilities, and with no clear plan of how to translate the broad objectives into well-specified and traceable goals (Funke and Nsouli, 2003). Most recently, it has been labelled as a “failure” by one of its founding fathers, the President of Senegal, Abdoulaye Wade, because among other things, it has not been able to build “... single mile of road”.
- 80 As mentioned earlier, the UK has moved ahead in untying its aid but other donors have moved more slowly. In addition, recent geo-political events suggest that tying may again be on the increase (Harford, 2003). There is already a trend for aid to be diverted from low-income countries in sub-Saharan Africa towards countries that are more strategically and commercially important to donors. The shift from low-income to middle-income countries is most evident for grants. In the 1970s, approximately 70 per cent of ODA grants went to low-income countries; by the 1990s, this share had fallen to 50 per cent (Klein and Harford, 2005: 28).
- 81 The EU’s structural funds include the European Regional Development Fund, the European Social Fund and the European Agriculture and Guarantee Fund. The estimated composition of funding by project type, taking Portugal in the mid-1990s as an example, are 45 per cent for economic infrastructure, 35 per cent for private-sector production and 20 per cent for human resources, cited by Abegaz (2005: 444).
- 82 For a discussion of some of the key issues on the reform agenda, see UNCTAD (2001b).

- 83 See, for example, Myrdal, 1956.
- 84 One of the important aspects of regional cooperation in post-war Europe is that it encouraged a focus on “nuts and bolts” cooperation in resolving possibly mundane but nevertheless important practical problems, such as trade facilitation, harmonizing standards for certain traded products, trans-boundary air and water pollution, and so on, where all the parties can see that they will gain from agreed rules or standards and so are encouraged to cooperate.
- 85 Likewise, the coherence between the Millennium Challenge Account and other parts of the system which base their allocations on poverty criteria has not been sorted out. It is still not clear whether other donors will alter the distribution of their funds if a country becomes a large recipient of MCA finance. In terms of the International Finance Facility, assuming it gets off the ground, its disbursement criteria will need to be devised in such a way that it avoids simply disbursing funds to countries already eligible for IDA finance. The implicit, collective decision-making this implies could potentially contribute to aid harmonization, but it remains to be seen if this is likely to occur.
- 86 For a suggestion along these lines, see Helleiner (2000).



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