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D. PUTTING AID TO WORK: SOME KEY ISSUES

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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.[34]

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).[35] 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 sells) 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.[36] 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.[a] 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.[37]

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,[38] 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,[39] 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. [40]

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.[41] 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.[42] 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.[43]

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.[44] However, the problem is more general.[45] 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).[46]

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.[47] 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 mot 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.[48]

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.[49] 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).[50]

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.[51] 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.[52] 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).[53] With few organizations leaving the scene, the aid arena has become a very crowded and chaotic place.[54]

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.[55] 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 (McGillivary, 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.[56]

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.[57] 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[58] 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.[59] 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.[60] 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.[61] Resources available through this concessional window have more that 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).[62] 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 then growth-enhancing investment.[63] 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.[64] 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.[65] 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).[66] 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.[67]

(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" (Buira, 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.[68] 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 conditionalty 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).[69] 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.[70]

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.[71]

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.[72]

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.