Foreign Aid in Africa: Role, Experiences and Challenges

First Draft

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<tbody>
<tr>
<td>AAP</td>
<td>Africa Action Plan</td>
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<td>AfDB</td>
<td>African Development Bank</td>
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<td>AIDS</td>
<td>Acquired Immune Deficiency Syndrome</td>
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<td>APF</td>
<td>African Partnership Forum</td>
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<td>APRM</td>
<td>African Peer Review Mechanism</td>
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<td>AU</td>
<td>African Union</td>
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<td>BOP</td>
<td>Balance of Payment</td>
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<td>DAC</td>
<td>Development Assistance Committee</td>
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<td>EPSA</td>
<td>Enhanced Private Sector Assistance</td>
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<td>EU</td>
<td>European Union</td>
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<td>HIPC</td>
<td>Highly Indebted Poor Country</td>
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<td>HIV</td>
<td>Human Immuno-deficiency Virus and Acquired Immune Deficiency Syndrome</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IFF</td>
<td>International Finance Facility</td>
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<td>IFFIm</td>
<td>International Finance Facility for Immunization</td>
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<td>IMG</td>
<td>Independent Monitoring Group</td>
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<td>MCA</td>
<td>Millennium Challenge Account</td>
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<td>MDR</td>
<td>Multilateral Debt Relief Initiative</td>
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<td>MDGs</td>
<td>Millennium Development Goals</td>
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<td>NEPAD</td>
<td>New Partnership for Africa’s Development</td>
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<td>ODA</td>
<td>Official Development Assistance</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PAFs</td>
<td>Performance Appraisal Framework</td>
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<td>UK</td>
<td>United Kingdom</td>
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<td>UN</td>
<td>United Nations</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
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<td>US</td>
<td>United States</td>
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<td>US$</td>
<td>United States Dollar</td>
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<td>WTO</td>
<td>World Trade Organisation</td>
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ABSTRACT

African governments have made commitments to implement national development strategies that incorporate MDGs based on domestic resource mobilization and support from the international development community. The implementation of national development strategies incorporating MDGs require a substantial scaling up internal and external resources and enhancing their effectiveness. In this context, the objective of this paper is to assess the role foreign aid problem in development in Africa, improve the understanding of the economic, institutional and governance impact of aid dependence and provide suggestions on how to make more effective use of aid and ultimately manage a smooth exit from aid dependence. Action will need to be taken on both sides to do the business of aid management differently from they have done in the past.

The evolution of the role of aid in development has reflected changes in development theory, existing data systems and change in the world economic environment. This road map has been invoked to enhance the understanding of interrelationships among development goals, development theories, policies and strategies and the position of aid has been shown to be evolving accordingly. Aid has been approached from a variety of perspectives. Economic development has evolved from the preoccupation on growth of GNP to progressively include concerns of balance of payments, employment, basic needs, income distribution (growth with equity), poverty, stabilization and structural adjustment, sustainability, world financial management and governance.

The impact of aid on most macroeconomic variables has not been simple and straightforward. It does exhibit more of a mixed picture of relationships rather than clear and significant causal relationships among them in most cases. The causal relationships may also be blurred by the varying policy environments under which aid has been managed in the recipient countries.

Aid can impact development via its impact on institutions and governance. The key finding of the research in this area is that institutions matter in mediating the impact of aid dependence. In response to these problems, new modalities involving the management and delivery of aid have been developed.

There have been concerns about scaling up aid since the Monterrey Consensus but there have also been increasing voices on the need to improve the effectiveness of that aid in especially in terms of realizing poverty reduction. The Paris Declaration has created space for stronger mechanisms for accountability and promoting a model of partnership that can improve transparency and accountability on the use of development resources.
The impact of aid and its effectiveness can be influenced by the way aid is managed. The way aid is managed is important in ensuring that it plays the intended role in development including successfully graduating from it. Proposals are made taking into account the changing context of aid. Proposals for improving management of aid address options of redefining partnerships and promoting ownership, improved coordination, enhancing capacity building and capacity to manage change, reducing transaction costs by improving aid delivery mechanisms and donor policies and practices and improving budget management systems and managing the exit strategy. An exit strategy is necessary from two points of view. First, it is quite possible that aid could be reduced influenced by factors on the donor side. Second, the recipient country should seek to graduate from aid dependence at some point considering that the rationale of aid is to enable the recipient to stand on its own feet. Elements of the exit strategy include building the capacity for meeting development goals, debt relief, direct foreign investment reversing capital flight, domestic resource mobilisation and export development. Monitoring commitments must take cognizance of the experience of the past and adopt an appropriate results-based approach, involve key stakeholders consisting of domestic constituencies on the side of donors and country partners and design and implement monitoring at national, regional and sub-regional and global levels and these complement and reinforce each other.
EXECUTIVE SUMMARY

Background and Context
African governments have made commitments to implement national development strategies that incorporate MDGs based on domestic resource mobilization and support from the international development community. These commitments have been made in the United Nations World Summit (Article 22) and at the G8 meeting in Gleneagles in 2005. The implementation of national development strategies incorporating MDGs require a substantial scaling up in public investments in a range of sectors, crosscutting areas and infrastructure. The required scaling up of financing will call for enhanced resource mobilization from domestic as well as from external sources. These resources will have to be utilized more effectively in order to realize positive development outcomes.

In this context, the objective of this paper is to assess the role foreign aid problem in development in Africa, improve the understanding of the economic, institutional and governance impact of aid dependence and provide suggestions on how to make more effective use of aid and ultimately manage a smooth exit from aid dependence.

The story that is told in this paper is that in order to achieve the development goals including the MDGs, the volume of aid (and therefore the level of aid dependence) to Africa but this higher volume of aid must managed more effectively drawing lessons from past experience. Action will need to be taken on both sides to do the business of aid management differently from they have done in the past. Both sides will have to mutually change their approach to aid management as well as adopt a clear strategy for managing the economy with a view of making it possible to achieve a smooth transition to less aid dependence.

The Role of Aid in Development
Aid in Africa is used to finance several types of activities: discrete investment projects; technical assistance (which is sometimes part of investment projects but frequently free-standing); budget support, often through funding associated with macroeconomic and sectoral reform programs; and debt relief, through the cancellation of debt. The various aid modalities have been changing over time presumably towards more effective modalities.

The real economic needs of African governments of resources to further their development and the efforts of aid donors to assist that development and respond to deepening economic crisis, the political and bureaucratic imperatives of aid donors to advance their broader diplomatic objectives and to expand overall aid levels and allocate all available to be spent; and the political goals of Africans to increase resources available for patronage and benefit from the various symbolic advantages that foreign aid provides.

The evolution of the role of aid in development has reflected changes in development theory, existing data systems and change in the world economic environment. This road map has been invoked to
enhance the understanding of interrelationships among development goals, development theories, policies and strategies and the position of aid has been shown to be evolving accordingly. Aid has been approached from a variety of perspectives. Economic development has evolved from the preoccupation on growth of GNP to progressively include concerns of balance of payments, employment, basic needs, income distribution (growth with equity), poverty, stabilization and structural adjustment, sustainability, world financial management and governance.

The impact of aid on most macroeconomic variables has not been simple and straightforward. It does exhibit more of a mixed picture of relationships rather than clear and significant causal relationships among them in most cases. The causal relationships may also be blurred by the varying policy environments under which aid has been managed in the recipient countries.

The impact on poverty is problematic and is less clear. The wider literature has indicated that effective anti-poverty action is difficult to achieve largely because the poverty problem is multidimensional, complex and location specific deeply rooted into the social fabric and distribution of economic and political power.

Aid can impact development via its impact on institutions and governance. During the period of economic reforms, many countries made improvements in the soundness of their macroeconomic policies but at the same time undercut ownership of the policy agenda. The key finding of the research in this area is that institutions matter in mediating the impact of aid dependence. In response to these problems, new modalities involving the management and delivery of aid have been developed. Specifically, there is an increasing emphasis on the part of donors on Sector Investment Programs (SIPs) and general budget support as a mechanism to coordinate donors within sectors and in the context of the broader budget management. As various recent studies have shown, general budget support has become more prominent in the late 1990s as part of the quest for more positive impact of aid on development with the overall assessment showing positive results in terms of harmonization and alignment, macroeconomic performance, service delivery and impact on broader policy processes.

Technical assistance has often been more supply driven than demand driven to the extent it has been provided independently of government plans, priorities, or requests. The literature on the role of TA has been pessimistic regarding the roles of performance of TA, training and capacity building.

Debate on aid effectiveness has drawn attention to the complexity of relationships between aid and policy. In spite of the debates around technicalities and methodologies, adopted, there is general agreement that aid works better in good policy environments. However, performance itself needs to be interpreted broadly beyond the issue of growth as such and extend to consider issues of poverty and human development. This finding helps to shift attention towards defining what constitutes good policy environment and striving to put it in place.
Financing Commitments

There have been concerns about scaling up aid since the Monterrey Consensus but there have also been increasing voices on the need to improve the effectiveness of that aid in especially in terms of realizing poverty reduction. The latter has been discussed in the context of improving the quality of aid. In this regard, commitments were made in 2005 by the United Nations, G8, European Union, and others to deliver more and better aid, more substantial debt relief and more coherent “joined up” policies in support of development that is consistent with achieving MDGs.

This degree of scaling up of ODA resource allocation gives Africa a real opportunity to meet the MDGs provided a concerted effort can be made to improve the quality of that aid. The G8 meeting at Gleneagles ended with a statement expressing the pledge to support sound development strategies with better aid as one way of ensuring that aid is used most effectively. Implementation would be motivated by all commitments that were made in the Paris Declaration on Aid Effectiveness. In this context, the commitments were made in accordance with five principles: ownership and leadership, alignment, harmonization, managing for results and mutual accountability. It was agreed to reaffirm the commitments to accelerate progress in implementation.

The Paris Declaration has created space for stronger mechanisms for accountability and promoting a model of partnership that can improve transparency and accountability on the use of development resources. What remains to be done is to review the progress made.

The financing commitments that have been made will only facilitate realization of desired outcomes if concrete action is taken to meet the commitments made in terms of quantity and quality. A review of progress that has been made towards meeting the commitments is made both in terms of quantity and quality of aid. The available data has indicated that the direction of change in 2005 compared to 2004 is encouraging. A major concern over the scaling up of aid has been the issue of predictability. Donors’ commitments have traditionally been quite short-term and delivery has been erratic. This issue deserves to be taken up as part of the options for improved monitoring.

As regards progress in quality of aid, the Paris Declaration on aid effectiveness developed twelve indicators to monitor progress in achieving results. The relationship between Africa and its development partners is undergoing radical change with the establishment by Africans of the African Union and NEPAD (an initiative that has been incorporated into the African Union). The level of engagement and the quality of policy discussion among Africans has evolved enormously over the last few years in all these areas. African countries are now more committed to good economic governance through improved macroeconomic stability, public finance management, accountability, resource mobilisation and financial and monetary institutions. The locus of intellectual work on African problems is in the process of shifting from international institutions and institutes to Africa. These are strong signs of genuinely African ownership of its political and economic development.
The mechanisms that have been set up in the context of the African Partnership Forum for monitoring and advancing implementation of commitments and using the Joint Action Plan of Commitments by Africa and the development partners is an encouraging step in the right direction.

**Improving Management of Aid for Development**

The impact of aid and its effectiveness can be influenced by the way aid is managed. The Marshall Plan for the reconstruction of Europe was managed to work effectively, in East Asia aid to South Korea and Taiwan worked effectively and in Africa aid to Botswana and Mauritius has been a success. These experiences indicate that aid management is important in ensuring that it plays the intended role in development including successfully graduating from it. Some reflections are made here in respect of aid regimes and the associated norms, principles and rules and procedures and reference is made to the emerging regime in which partnerships, ownership, holistic frameworks are being revisited. Proposals are made taking into account the changing context of aid. Proposals for improving management of aid address options of redefining partnerships and promoting ownership, improved coordination, enhancing capacity building and capacity to manage change, reducing transaction costs by improving aid delivery mechanisms and donor policies and practices and improving budget management systems and managing the exit strategy. An exit strategy is necessary from two points of view. First, it is quite possible that aid could be reduced influenced by factors on the donor side. Second, the recipient country should seek to graduate from aid dependence at some point considering that the rationale of aid is to enable the recipient to stand on its own feet. Elements of the exit strategy include building the capacity for meeting development goals, debt relief, direct foreign investment reversing capital flight, domestic resource mobilisation and export development.

**Options for Monitoring of Commitments**

Monitoring commitments must take cognizance of the experience of the past and adopt an appropriate results-based approach, involve key stakeholders consisting of domestic constituencies on the side of donors and country partners and design and implement monitoring at national, regional and sub-regional and global levels and these complement and reinforce each other. The following actions are recommended:

**Action at the country level**

- At the country level there is a real need for a set of country targets to be agreed upon between donors, governments and civil societies with the aim of improving the quality of aid and accelerating its disbursement. Initiatives like the IMG concept in Tanzania could be replicated with adaptations as may be needed to reflect concrete country specific situations.
- Partner countries should identify preferred aid modalities and establish indicators of progress towards those aid modalities and take actions which facilitate movement towards those aid modalities. In this context, priority should be placed on developing the capacity to analyse
various aid delivery mechanisms and modalities and proactively lead aid management and co-
ordination processes.

- Governments should be encouraged to establish clear aid management policies (e.g. Tanzania
  Joint Assistance Strategy, Uganda and others).
- The governments should improve their aid statistics and have them disaggregated in a manner
  which would help to identify which donor flows are truly helping governments to scale up and
  giving them fiscal space to effectively implement their development strategies for achieving
  growth and poverty reduction targets which will have incorporated strategies for achieving
  MDGs.
- In order to mitigate the problem of unpredictability African governments should prepare a 10
  year development programme with its financial implications for achieving the MDGs clearly
  shown. These programmes should be the basis for discussing with donors and making them
  commit resources over a 10-year time horizon or as close to 10 years as would be permissible.
- There is need to establish medium- and long-term development finance scenarios as a
  roadmap for setting framework conditions for aid, domestic resource mobilization and foreign
direct investment and paving the way for rising domestic resource mobilisation and intermediation
to ensure that short- and medium-term increases in aid dependence (which may
be necessary at this stage for meeting MDGs) do not become permanent features in African

economies.

Action at the regional/sub-regional level

- Collective action is needed in the spirit of collective action to address the challenges and
  problems which are common to several countries in the region. The regional and sub-regional
  level organisations should take initiatives to step up collective action not only in managing the
  aid process but also in increasing the African voice in the WTO and other global negotiations.
- Mechanisms that have already started working in the regional context should be strengthened.
The role of APRM, an institutionalized source of peer pressure to improve governance is an
encouraging development in putting the mandate of improving governance in the hands of
Africans. The work of APRM needs to be extended to the area of economic governance and
economic management.
- The participation of Africa at regional level should be stepped up to participate more effectively
  in learning groups and exchanging experiences in the evolving aid relationships. Organisation
  of other stakeholders should be encouraged to support the monitoring process

Action at the global level

- It is proposed that high priority be accorded to strengthening the African Partnership Forum
  (APF) as the main forum for monitoring and reviewing progress including delivery of
  commitments made by all countries. The way forward now is to facilitate the APF to more
effectively monitor donor and African commitments. The challenge here is to ensure
involvement of high level political representation to provide the political will necessary to turn commitments into action.

- The launching of the DAC Monitoring Survey should be followed by its operationalisation and should be widely supported by the members who endorsed the Paris declaration.
- The efforts that are being made in the new Strategic Partnership for Africa should continue to be strengthened to effectively complement the global monitoring mechanisms.
- Networks of civil Society organisations at national, regional and global level should be encouraged to support the monitoring process.
- The World Trade Organization (WTO) where the rules of trade between nations are negotiated and agreed should be used more effectively. It is vital that Africa organizes itself, as it has already started doing under auspices of the African Union, to use the WTO ministerial meetings to make real progress towards a fairer trade system. Specific commitments such as ones to end cotton subsidies by the end of 2006 and to end all agricultural export subsidies by 2013 as agreed in the World Trade Organization’s Ministerial in 2005 should be monitored closely. The initiatives to monitor these commitments should be built into the WTO Ministerial meetings as a permanent agenda.
- Concerns over absorptive capacity should be addressed by making the country level medium- and long-term development finance scenarios as a roadmap for setting framework conditions for aid with technical support from the IMF. The IMF should play the role of advising governments on the various scenarios and their implications on macroeconomic management.
- The DAC/World Bank initiative to survey donors’ forward aid plans and the World Bank/UNDPs work to offer annual "Results and Resources Meetings" to developing countries will help to build clearer pictures at the country level of future aid flows.
- The initiative that the UN Secretary General has taken to appoint a High Level Panel to consider fundamental restructuring of UN agencies at the global and country level should be supported. In this regard, lessons can be drawn from countries where restructuring of the UN’s work at the national level has been addressed e.g. Tanzania.
Foreign Aid in Africa: Role, Experiences and Challenges

1.0 BACKGROUND AND CONTEXT

African governments have made commitments to implement national development strategies that incorporate MDGs based on domestic resource mobilization and support from the international development community. These commitments have been made in the United Nations World Summit (Article 22) and at the G8 meeting in Gleneagles in 2005. The implementation of national development strategies incorporating MDGs require a substantial scaling up in public investments in a range of sectors, crosscutting areas and infrastructure. The required scaling up of financing will call for enhanced resource mobilization from domestic as well as from external sources. These resources will have to be utilized more effectively in order to realize positive development outcomes. It should be noted that at the aggregate macro-economic level, the bulk of investments and government revenue come from domestic sources. Therefore any discussion on financing development must take domestic sources as the primary source and mobilize foreign sources only to complement the domestic resource mobilization efforts.

In this context, the objective of this paper is to assess the role of foreign aid problem in development in Africa, improve the understanding of the economic, institutional and governance impact of aid dependence and provide suggestions on how to make more effective use of aid and ultimately manage a smooth exit from aid dependence. Management of the transition to less aid dependence is guided by the premise that reduction of aid dependence is to be take place in the context of enhanced rather than disrupted socio-economic development in Africa while promoting appropriate integration of Africa into the world economy. The smooth transition is expected to be consistent with successful integration of the African economies into the global economy.

The story that is told in this paper is that in order to achieve the development goals including the MDGs, the volume of aid (and therefore the level of aid dependence) to Africa may have to increase initially before it starts to decline. However, in the transition period action will be required both from Africa and the developed partners in the developed world to make it possible to raise the quality of aid in terms of its effectiveness in preparing conditions for a smooth transition from aid dependence and facilitate appropriate integration into the global economy. Action will need to be taken on both sides to do the business of aid management differently from they have done in the past. Both sides will have to

1 DFID. Gleneagles Implementation Plan, 2005.
mutually change their approach to aid management as well as adopt a clear strategy for managing the economy with a view of making it possible to achieve a smooth transition to less aid dependence. The increase of aid volumes at least initially will be realized to the extent aid commitments are realized and mechanisms for improving monitoring of these commitments are put in place as well mechanisms for monitoring the effectiveness of aid.

Following this background and context, section 2 examines the role of aid in development while section 3 examines commitments made in financing for development. Section 4 examines management of aid and the role of management in influencing aid effectiveness highlighting the mutual responsibilities of Africa and the development partners in the developed world. Section 5 addresses options for improving monitoring of the financing commitments and makes recommendations for the way forward. Section 6 is the conclusion.
2.0 THE ROLE OF AID IN DEVELOPMENT

2.1 Financing Development

Aid in Africa is used to finance several types of activities: discrete investment projects; technical assistance (which is at times part of investment projects but frequently free-standing); budget support, often through funding associated with macroeconomic and sectoral reform programs; and debt relief, through the cancellation of debt.

The largest proportion of aid worldwide has long been provided for investment projects - for example, the construction of infrastructure, the expansion of social services, or the financing of research. The sectoral focus has differed from one country to another and there have been considerable shifts over time. In general, however, sector-wide economic infrastructure and directly productive sectors received a large share in the earlier period consistent with project aid while social sectors and economic management have received greater priority in the more recent years. After declining over several decades, technical assistance appears to have risen again in recent years, reaching one-quarter of aid to Africa at present. In the early years of African independence, a significant proportion of aid was provided as budget support to governments such as Botswana, which did not yet have revenue flows adequate to finance their expenditures. Budget support fell during the 1970s but began to increase again during the 1980s with the rise in structural and sectoral adjustment programs, which provided aid in support of economic policy reforms. In addition, aid for debt relief has increased in recent years as donor governments and multilateral development banks have moved to reduce the high debt burden of African countries through bilateral debt restructuring, outright cancellation and through the World Bank-led initiative for reducing the multilateral debts of Highly-Indebted Poor Countries (HIPC), many of which are in Africa.

The categories of project and program aid can be misleading, however, it terms of the real uses of the aid. Aid is “fungible” – that is, it can be used to fund activities that the recipient government intended to finance in the absence of the aid. When this is the case, aid in effect frees up government resources to be used elsewhere – for other investments, consumption, tax reductions, debt servicing, war or other purposes.

How fungible is aid to Africa? A study undertaken for this project by Shantayanan Devarajan, Andrew Rajkumar and Vinaya Swaroop (1998)², using a panel database from 18 countries in SSA, revealed that foreign aid (not including technical assistance grants) boosted government expenditures by nearly the amount of the aid (90 percent), indicating that governments were not simply using the aid to replace

taxes. However, about half of the aid was used to fund external debt service. The rest of aid was divided equally between funding capital and current accounts (i.e., funding investments and on-going expenditures) by governments. Aid is found to be partially fungible. Every dollar of aid leads to about 90 cents of government spending distributed equally in capital and current expenditures. Equally, aid resources have been used to finance debt service payments. The fungibility of loans intended for particular sectors in Africa roughly mirrors a pattern found in a broader sample of countries. Even in the partially fungible sectors, governments spend more out of aid than they do out of their own resources at the margin. At the level of sectors, governments in Africa do not spend all sectoral aid in that sector nor do they treat such aid as merely budget support. This implies that Aid in Africa is partially fungible. It is also found that as the number of donors increase aid is more likely to become fungible (Lancaster and Wangwe, 2000). These findings suggest that it is very challenging to assess the differential impact of the different types of aid (project, program, technical assistance) on aid dependence considering that fungibility of aid can obscure the “real” uses of any particular aid expenditure. More effective approaches to monitoring the use of aid will need to be explored beyond broad categories of use of aid. Fungibility can be interpreted as a reflection of non-harmonisation of views of donors and recipients in respect of priorities. In this context, fungibility of aid has policy implications in favour of aid coordination and the need to pay greater attention to the quality of the overall public expenditure programme of recipient countries. It underlines the importance of enhancing the capacity for budget management to ensure effective use of all public resources irrespective of source (internal or external).

2.2 The Role of Aid and Its Impact in Development

The real economic needs of African governments of resources to further their development and the efforts of aid donors to assist that development and respond to deepening economic crisis, the political and bureaucratic imperatives of aid donors to advance their broader diplomatic objectives and to expand overall aid levels and allocate all available to be spent; and the political goals of Africans to increase resources available for patronage and benefit from the various symbolic advantages that foreign aid provides. The justifications for aid have been articulated over the years and they do not need any further elaboration.

2.2.1 The Evolution

The evolution of the role of aid in development has reflected changes in development theory, existing data systems and change in the world economic environment. This road map has been invoked to enhance the understanding of interrelationships among development goals, development theories, policies and strategies and the position of aid has been shown to be evolving accordingly. Aid has been approached from a variety of perspectives. The end of Second World War (WWII) marked the beginning of a major change in the evolution of the world economy and foreign aid came to the scene in the context of the emergence of a large number of new nation states as the process of decolonization
was sweeping. In the course of the last 50 years many lessons have been learned about development policy and the role of aid in addressing these problems has also evolved considerably. Economic development has evolved from the preoccupation on growth of GNP to progressively include concerns of balance of payments, employment, basic needs, income distribution (growth with equity), poverty, stabilization and structural adjustment, sustainability, world financial management and governance. As the perspective of development has been changing and its interpretation broadening so has the role and position of aid (Thorbecke, 2000). A close interdependence has been demonstrated among development objectives, the conceptual framework and models, data systems and information, strategies and the role of foreign aid (Thorbecke, 2000). The perception of the role of foreign aid has shifted considerably from the one-dimensional concern about resource mobilization to close the investments-savings gap or the foreign exchange gap into a more multi-dimensional role and the justification of aid has evolved accordingly.

The development paradigm of the 1950s was dominated by one-sector models of growth coached under the Harrod-Domar model, a paradigm in which foreign aid was seen as a source of capital to trigger higher growth through higher levels of investment. In the 1960s, with the rise of balance of payments concerns, the two-gap models became dominant and the role of foreign aid became that of filling the two gaps (investment-savings gap and the foreign exchange gap). The development paradigm of the 1970s was driven by concerns about employment, basic needs and income distribution, a paradigm in which the role of foreign aid was to raise the standard of living of the poor largely through increased employment. In the 1980s, stabilization and structural adjustment policies were adopted and foreign aid was used to mitigate the adverse effects of debt and to induce countries to adopt the proposed SAPs by presumably absorbing the shock and other negative effects of SAPs. In the 1990s, the trend towards integrating poverty concerns in development and towards comprehensive models of development emerged. In this development paradigm a multi-dimensional perspective to development putting on the agenda concerns about ownership and good governance as important influences on aid effectiveness. The debate about the effectiveness of aid has continued to rage especially in recent years taking advantage of availability of a wider range of sophisticated analytical tools and more comprehensive data (Tarp, 2000). The issue of the effectiveness of aid conditionality was critically debated with a major study showing that aid cannot buy reforms (Devarajan et al, 2001). This development paradigm involves commitments on the part of aid donors to four elements: selectivity, participation, ownership, and developing new modalities for managing the aid. These elements are being shaped within the broad conceptual context of the Comprehensive Development Framework (CDF) proposed by the World Bank building on international poverty reduction goals agreed in the DAC in 1995 (OECD, 1996).

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These have been further refined in the Rome Declaration (2003) and the Paris declaration (2005). The development paradigm that underlies the Paris Declaration on Aid effectiveness has underscored five principles: ownership and leadership, alignment, harmonization, managing for results and mutual accountability. It was agreed to reaffirm the commitments to accelerate progress in implementation.

2.2.2 Macroeconomic Impacts of Aid

The impact of aid on most macroeconomic variables has not been simple and straightforward. It does exhibit more of a mixed picture of relationships rather than clear and significant causal relationships among them in most cases. This outcome may be a reflection of a weakness of statistics to enable rigorous and robust statistical analysis to be done. The causal relationships may also be blurred by the varying policy environments under which aid has been managed in the recipient countries.

The studies on the impact of aid on growth have used various models. For instance, the Harrod-Domar model linking growth to aggregate investment has provided the core of the underlying economic paradigm for analysing the impact of aid and aid effectiveness at the macroeconomic level. The extensions into the new growth models have provided the analytical basis for a few recent empirical cross-country studies. In the new growth theory approach, the investment variable and productivity are assumed to depend on policy and institutional variables (Robinson and Tarp, 2000).

The results of studies of the impact of aid on aggregate growth have been mixed. In general, however, a survey of three generations of empirical work (early Harrod-Domar models, reduced form aid-growth model and new growth theory reduced form models) has found that aid increases aggregate savings, aid increases investment and that there is a positive relationship between aid and growth in reduced form models. The positive aid-growth link is found to be robust in all three generations of empirical work (Hansen and Tarp, 2000). When all the studies are considered as a group, the evidence on the positive aid-growth relationship is found to be convincing. However, this relationship is not automatic. Its strength is subject to influence of policy as suggested by Burnside and Dollar (1997). Policy can influence aid effectiveness. The implementing and monitoring of commitments under the Paris Declaration is likely to play an important role in realizing the effectiveness of aid.

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The review carried out by Azam and Fouda (1998) found that most of the papers reviewed found a negative impact on the rate of savings. The results of the analyses of impact of aid on investment and that on growth are found to be very mixed. In the case of Tanzania, it has been observed that from independence to around 1977/78 aid played an important role in bridging the two-gaps (savings-investment gap and the foreign exchange gap). Achievements were impressive in terms of economic growth averaging about 5% during 1961-78 and in terms of rapid development of the social sectors. However, it also means that by filling the two-gaps (investment-savings gap and the foreign exchange gap) aid contributed to reducing the need or the pressure to make timely adjustments to avoid nurturing an economy living beyond its means. The case of Ethiopia has shown that the share of investment in GDP has increased with aid. It was found that aid had a positive impact on public expenditure and a negative impact on revenue. It was also found that there was a Dutch disease effect in Ethiopia unlike the case of Botswana where that situation was taken care of through proper management (Lancaster and Wangwe, 2000). The case study on Mali found that there was a positive impact of aid on investment and saving. However, the results show that aid was not effective in the growth process suggesting that the positive effect on investment and savings was not translated into growth.

Investments have not always been translated into increased growth of the economy. Domestic policy can influence the impact of aid on growth through the investment channel. In the case of Tanzania for instance, it was argued that in the 1970s, aid effectiveness was reduced because of weaknesses in domestic economic management.

Another factor that has been influencing the effect of aid on growth is uncertainty. Lensink and Morrissey (1999?) found that when uncertainty of aid is taken into account aid is found to have a significant positive effect on growth, largely due to its effect on the volume of investment. The finding that uncertainty reduces the effectiveness of aid is robust. This suggests that stability in donor-recipient relationships leading to improved predictability of aid flows could enhance aid effectiveness.

Guillaumont and Chauvet (1999) found that the cross-sectional econometric tests related to GDP growth on two twelve-year pooled periods favour the assumption that aid effectiveness depends on the external and climatic environment more than the assumption that aid is effective only if domestic policies are good. They suggest that the two views can be reconciled by adopting the principle of performance

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8 Jean-Paul Azam and Seraphin Fouda. The Economic Impact of Aid on Recipients. Framework Paper for this Project.
9 Robert Lensink and Oliver Morrissey. Aid Instability as a Measure of Uncertainty and the Positive Impact of Aid on Growth. CREDIT. University of Nottingham, 1999.
based aid allocation whereby performance is taken to mean outcomes adjusted for the impact of environmental factors. According to such a principle more aid would be allocated the worse the external environment (for a given policy) and the better the policy (for a given external environment). They rightly caution about the possibility of designing selectivity on the basis of a fragile assessment of the influence of aid effectiveness. It is shown that the influence of aid is more positive in countries which are more vulnerable to exogenous factors. In such cases aid is found to have significantly dampened the negative effects of hostile external factors (Guillaumont and Chauvet, 1999).

The conventional macroeconomic rationale for foreign aid is to supplement domestic savings, foreign exchange and government revenue thereby contributing to higher growth. In reality this otherwise simple relationship is complicated by at least three factors:

(i) Fiscal status
The effects of aid on government fiscal behaviour of government reveals two strands. First, the literature is explicitly concerned with the fungibility of aid as regards government spending patterns. The second strand adopts the fiscal response models in an attempt to analyse the effect of aid on various components of government revenue and expenditure.

(ii) The Debt Problem
The problem of foreign debt has taken two strands. First, debt payments have been acknowledged as a further drain on foreign exchange and government revenue. Second, debt adversely affects public expenditure (reducing opportunities for crowding in private investments) and debt overhang has been associated with disincentives such as tax disincentives and macroeconomic instability. The study by Fosu (1999) on debt burden and economic growth in 35 SSA countries found that net outstanding debt was deleterious to economic growth for given levels of production inputs. The reduction of growth works via reduced productivity of investments. The finding that nearly half the aid was used in effect to service external debts suggests that much of the aid was essentially a pass through -- from the donor, through the African recipient and on to the external creditor (which was often also the donor).

(iii) Dutch disease effects whereby aid affects the exchange rate and the general competitiveness of the export sector.

Over the longer run foreign aid should go beyond the rather passive role of filling these gaps towards more actively engaging aid the process of closing these gaps in the context of heading for a smooth exit from aid dependence by taking such actions as using aid to stimulate exports, investing in expanding
infrastructure and in improving systems of domestic resource mobilization and public expenditure management (Hjertholm, Laursen and White, 2000)\textsuperscript{11}.

Studies of impact of aid have often taken aid in its aggregate and has therefore not addressed the composition of aid. The composition of aid matters and has influenced shifts in forms of aid. Various studies have shown that some forms of aid have been more effective than others. The shift from project to programme aid that has been observed in some countries in the 1980s is one response to the perception that project aid was not working especially as the recurrent budget allocations needed to utilize effectively the installed capacities became more and more under strain. The effectiveness of technical assistance has also been put into question. Technical assistance has sometimes been associated with underutilization of local human resources and failure to build up local capacities.

2.2.3 Impact on Poverty

The impact on poverty is problematic and is less clear. The wider literature has indicated that effective anti-poverty action is difficult to achieve largely because the poverty problem is multidimensional, complex and location specific deeply rooted into the social fabric and distribution of economic and political power (Healey and Killick, 2000)\textsuperscript{12}. One implication of these findings is that donors need to be more realistic about the severity of the difficulties that are likely to be encountered and the scale of effort needed to overcome poverty. Most evaluations have shown that achievements in this area are modest at best. In general, it was found that there is a wide gap between the stated commitments to poverty reduction and the actual practices of reducing poverty in the field. Most donors have paid little attention to conceptualization and analysis of poverty and have been particularly weak in translating the poverty reduction objective into operational guidance and in their country assistance strategies. The main instrument of intervention has been a series of ad hoc projects and in these improvements have been observed over time in respect of participation by beneficiaries and gender sensitivity but few donors have been concerned about sustainability.

2.2.4 Impacts on Institutions and Public Sector Management

Aid can impact development via its impact on institutions and governance. During the period of economic reforms, many countries made improvements in the soundness of their macroeconomic policies but at the same time undercut ownership of the policy agenda. Many adjusting countries under the policy reform programs paid so much attention to meeting targets agreed between them and the multilateral financial institutions that the policy making process became a collaborative effort only in principle. In practice the recipient countries became more dependent on these institutions. Five year development plans were suspended and their place was taken by the shorter term economic recovery programmes couched in the Washington Consensus than to the wishes of the stakeholders in the recipient countries. The outcome was considerable erosion of ownership of the policy agenda.

In response to these problems, new modalities involving the management and delivery of aid have been developed. Specifically, there is an increasing emphasis on the part of donors on Sector Investment Programs (SIPs) and general budget support as a mechanism to coordinate donors within sectors and in the context of the broader budget management.

An effort to assess progress under four SIPs showed that most had been useful in helping the governments gain information and a measure of control over the multiple donors operating in various sectors in their countries. There were capacity problems however, in most cases in carrying out those strategies, especially where local governments were involved. SIPs threaten to centralize decision making and to jeopardize decentralization and broad participation in development management. In several cases, donors were reluctant to coordinate or pool their financing – at times, because they were uncertain of the financial capacity and probity of government ministries. These preliminary findings suggested that SIPs were potentially highly useful, albeit challenging to implement by both donors and recipients.

As various recent studies have shown, general budget support has become more prominent in the late 1990s as part of the quest for more positive impact of aid on development (IDD,2006). The overall assessment of five out seven country studies showed positive results in terms of harmonization and alignment, macroeconomic performance, service delivery and impact on broader policy processes. The studies have demonstrated that general budget support has a relevant response to certain acknowledged problems in aid effectiveness and in particular, it was found to be an efficient, effective and sustainable way of supporting growth enhancing and poverty reduction strategies.


The key finding of the research in this area is that institutions matter in mediating the impact of aid dependence. Foreign aid, provided in relatively large amounts over an extended period of time, can strengthen or weaken the institutions (including both the organizations and the norms, principles, and patterns of behaviour) in the countries receiving it. Aid can strengthen organizations by expanding the technical and administrative capacity of their staffs and by increasing their activities, which in turn can promote organization learning and broader economic development, eventually obviating the need for foreign aid. But it can also weaken recipient country institutions by undercutting the planning, budgeting, administrative capacities and general operations of recipient organizations and their political accountability and legitimacy. It can also reduce the sense of initiative and responsibility on the part of individuals in recipient organizations for achieving their goals and missions.

The difference between these two institutional outcomes of aid dependence turns on how the aid is managed by donors and recipients. Where the recipient government has been led by individuals committed to development and disciplined in their pursuit of it, and where recipient governments have had the capacity to manage the aid as well as coordinate the aid donors – as in the case of Botswana (more on this in the next section) – aid dependence has served to both strengthen institutions and spur development. In the numerous countries in Africa where this has not been the case, aid dependence has further weakened the organizations and processes necessary to manage an economy effectively (as well as foreign aid itself). In the case of Botswana high levels of aid reinforced local capacity enabling it to graduate to less aid dependence and in most other countries aid dependence caused erosion of local capacities and institutions thus reinforcing further aid dependence.

In addition, the system of accountability can be distorted by aid. Where organizations derive a significant proportion of their revenues from aid donors or other sources, their accountability will tend to shift to those sources, lessening their accountability to domestic constituencies in Africa. The high level of aid to African government over several decades has had that effect.

Another aspect of the various regimes in which foreign aid has been provided to African governments added to problems of capacity in those countries. The multiplicity of uncoordinated aid donors created serious transaction and coordination costs for African officials who had to receive senior officials from numerous aid agencies, attend conferences, try to implement (or at least, keep tract of) the many aid projects of those donors (each with its own administrative and budgetary systems and cycles) while attempting to manage their ministries or agencies. The sheer number and diversity of aid donors often overtaxed senior African government officials who were also typically the key decision makers in their ministries.
Several case studies have demonstrated that domestic capacity was partly eroded by the way aid was delivered and the conditionality that was attached to aid delivery. The economic crisis of the 1980s, coupled with policies directed towards reducing the size of the government contributed towards eroding the government machinery’s capacity. The capacity of the state in policy analysis and economic management has also been reduced. Aid has been coming in the form of projects or programmes for which parallel administrative machineries have been established. Such parallel machineries have formed island projects with their own administrations. These administrations, however, have exerted pressure on the existing administrative machinery (within the government), at least in two ways; by employing some public servants in these projects, or by demanding too much time from the officials in the respective ministries. This has tended to erode rather than build the limited capacity within the government. Second, most forms of aid have tended to be more of the capacity-utilizing type and less of the capacity-building type.

The impact of aid in public sector management has been evaluated and found that the record of the past 15 years shows little donor creativity, adaptability and flexibility in coping with the circumstances of low income countries with weak administrative institutions (Berg, 2000).15

2.2.5 Technical Assistance

Technical assistance has often been more supply driven than demand driven to the extent it has been provided independently of government plans, priorities, or requests. A syndrome is occurring in many countries in which weak governmental capacity and efforts to downsize the civil service lead to an increase in aid-funded technical assistance that replaces indigenous expertise and further reduces the capacity of government agencies to manage their own affairs effectively.16 The literature on the role of TA has been pessimistic regarding the roles of performance of TA, training and capacity building.

The effectiveness of technical assistance has also been put into question. Technical assistance has sometimes been associated with underutilization of local human resources and failure to build up local capacities. The consequent displacement of local human resources and institutional distortions could not have been conducive to growth. Concern has been voiced about the problem of packaging aid and recipients have little choice to make in terms the aid components they really need. In particular, projects packaged with personnel and equipment like computers and vehicles have sometimes been accepted because of the equipment even when technical assistance personnel were really not needed. To the extent that the composition of aid and its administration have had influence on the building or erosion of

institutional and human capacities in the recipient countries, a disaggregated analysis of aid and its components could have brought out important policy implications for improving aid effectiveness. In particular, the literature has demonstrated the failure of the expert-counterpart model. The value of long term resident advisers for capacity building has found to be low especially when expatriate residents are not placed in clear lines of authority within the local administrative structure (Arndt, 2000)\(^{17}\).

### 2.2.6 Impact on Policy

Debate on aid effectiveness has drawn attention to the complexity of relationships between aid and policy. In spite of the debates around technicalities and methodologies, adopted, there is general agreement that aid works better in good policy environments. In general, where policy performance is good aid tends to work. However, performance itself needs to be interpreted broadly beyond the issue of growth as such and extend to consider issues of poverty and human development. This finding helps to shift attention towards defining what constitutes good policy environment and striving to put it in place.

The extent to which aid allocation has been able to induce good policies is not encouraging either. Burnside and Dollar (1997) performed on econometric investigation on this relationship and failed to find any significant effect of aid on policy on average. Taking into account different contributions on the practice of conditionality Azam and Fouda have provided further arguments in favour of an outcome-based conditionality as a means to optimize the economic impact of aid on recipients.

Conditionality has influenced the kinds of policies that were adopted. Linking aid delivery to adoption of SAP policy reforms in the 1980s meant that liberalization of policies was made towards a particular type of policy package. SAPs are mainly focusing on macroeconomic stabilisation, public sector reform and liberalization of markets and trade. However, the relationship between aid and policy is more complex.

The approach adopted in the Burnside and Dollar (1997) study explicitly models the simultaneous interactions among aid, policy and growth. This approach faces an identification problem of whether aid causes policy or good policy attracts aid. It would appear that there is no simple answer to this identification problem. However, the studies of aid in some recipient countries (e.g. Tanzania) have suggested that it is important to distinguish the practice of the 1960s and 1970s on the one hand from the practice of the 1980s and 1990s on the other. During the 1970s aid allocation was influenced by the degree to which the development philosophy proclaimed by the recipient country was perceived to be congruent to that of the donor. It is in this context that Tanzania, for instance, received considerable aid from social democratic governments of the time. Change of governments in the North in the late 1970s

(e.g. USA, UK, Germany) coincided with questioning these kinds of relationships between aid and policy. It is at this time that questions of macroeconomic policies were introduced in the aid agenda. From the 1980s explicit reference began to be made to the kinds of macroeconomic policies that countries should be pursuing if they were to continue receiving aid from multilateral financial institutions (IMF and World Bank). In response to the perception that aid effectiveness was impaired by pursuit of poor policies donors led by multilateral institutions became quite explicit in tying aid to the kinds of policies that the recipient countries were pursuing. Even when bilateral donors were not explicit about this new policy stance their actions were influenced by the stance taken by the multilateral institutions. It is in this context that the concept of “seal of approval” gained recognition in the literature on aid and policy making in developing countries.

It would appear that prior to the 1980s policy caused aid (to the extent donors allocated aid because they endorsed the development philosophy which the recipient followed) while in the 1980s and 1990s it is more likely that aid caused (or at least it deliberately attempted to cause) policies through explicit conditionality on macroeconomic stabilization policy and later on institutional reforms.

A further point to note is that over time there has been policy learning on the part of governments and multilateral institutions which have been administering policy conditionality. What was “good” policy in the mid-1980s has been modified considerably since the 1990s (e.g. the comprehensive development framework). It is clear that the concept of “good” policies has also been evolving benefiting from experience over time. In this context, to have regression using a fixed index of policy over a long period of time can lead to ambiguous or misleading results. Measuring good policies in terms of the level of a scalar policy index arrived at by weighting three elements of standard macroeconomic policies as represented by budget surplus, inflation and openness is not an adequate representation of what may constitute good policy. The fact that the econometric results are reasonable may be a reflection of a high correlation between these three elements of policy and the more complex array of policies which have not been entered in the index.

The targets of macroeconomic policy as defined in the study may be achieved but at high cost in terms of disruption of the economy depending on the process and path they take. The process adopted in achieving inflation control, reducing budget deficits and opening up the economy and how these are sequenced can be as important in signifying good policy, if not more important than the quantitative targets that are reached at a point in time. The quality of policies pursued is not fully reflected in the observable quantities like rate of inflation, size of budget deficit or level of tariffs. The process and path which the country goes through to achieve those targets is probably more important in determining good policy. Inflation can be reduced through a credit squeeze to the detriment of pro-investment initiatives; budget deficits may be reduced by cutting down on growth promoting public expenditure such as infrastructure; and trade openness may be achieved in ways which may erode key domestic production
activities. Openness may devastate domestic industry if complementary policies are not put in place to promote potentially efficient economic activities. In this context, the World Development Report (1997) and the Trade and Development Report (1997) have cautioned about the risk that trade liberalisation may bring in terms of erosion of domestic industry and employment and the need to implement a carefully phased liberalization.

What is of greater concern is that the policy index and the structural model used in the study do not give due weight to the process of policy making and dynamics of shifting from poor policies to good policies. In practice, policy improvement is much more demanding than the achievement of targets on the three elements would suggest. The experience of policy making in many developing countries has shown that challenges of policy making involve many more policy instruments depending on the development objectives that a country sets out to achieve. For instance, poor countries may choose to pursue policies which enhance pro-poor growth. In such cases the process of shifting from bad policies to good policies and the path that such a shift would take would differ from a situation where only macroeconomic stability was sought. The dynamics of policy making and policy improvement are therefore important. This shift is a process which has occurred in many developing countries even if for some of them it may not have been translated as yet into what would pass as good policies in terms of the policy index used in the study. There are useful lessons to be learned about the process of policy making, the path followed in shifting towards good policies and sequencing of policy instruments and how best to combine different policy instruments.

The process of building the capacity for policy analysis and economic management faces greater challenges in developing countries which are also undergoing the transition from public sector led and administratively controlled economies towards private sector led market economies and from one party closed political systems to more open multiparty political systems. The situation is complicated further by the imperatives of globalization. The challenges of policy making under the new conditions of economic and political liberalization and the globalization process call for more explicit support for building the capacity for managing the path towards good policies. This is much more demanding than achieving selected quantitative macroeconomic policy targets. Development assistance should be directed towards supporting the build up, rather than erosion, of this capacity.

The policy process deserves greater attention than has been the case in past. In particular, the need to build the capacity for public finance management and policy coordination is an important aspect of paving the path towards good policy making. The many cases of failure to meet local financial obligations in aid projects, a situation which limits aid effectiveness, is largely a reflection of the low capacity for budget management even when this problem may not shown explicitly in the size of the budget deficit. In such cases budget ceilings may be observed (an aspect of “good policy”) but at high cost in terms effectiveness and efficiency in project implementation.
3.0 **THE FINANCING FOR DEVELOPMENT COMMITMENTS**

There have been concerns about scaling up aid since the Monterrey Consensus but there have also been increasing voices on the need to improve the effectiveness of that aid in especially in terms of realizing poverty reduction. The latter has been discussed in the context of improving the quality of aid. In this regard, commitments were made in 2005 by the United Nations, G8, European Union, and others to deliver more and better aid, more substantial debt relief and more coherent “joined up” policies in support of development that is consistent with achieving MDGs.

3.1 **Financing Development Commitments: Quantity**

The G8 summit in Gleneagles, addressed the recommendations of the Commission for Africa Report (2005) and came out with financing commitments by leaders of the rich world to increase aid to developing countries and to adopt aid delivery and management approaches and practices that would enhance the quality of aid with a view to making aid more effective in meeting the development goals. The G8 summit in Gleneagles made commitments to increase the level of ODA to developing countries by around $50 billion a year by 2010 as compared to 2004 levels of which about $25 billion would be allocated to Africa. The outcome would be the doubling of aid to Africa to about $50 billion per year.

The OECD predicts that total aid levels in 2010 will be $128 billion, an increase of $48.5 billion over 2004 levels. This includes commitments from all the G8 countries at the June European Council. The EU Member States committed to spend 0.7% of their national income on aid by 2015, and double EU aid by 2010 by providing an additional $40 billion with new interim collective target of 0.56 % ODA/GNI by 2010.

Table 3.0 shows a beginning of meeting these commitments as reported by the OECD and DAC at the end of 2005 year. The complete set of data on actual developments for 2005 is expected to be released in December 2006.

Commitment has been made to cancel debt immediately starting with the debts of 18 of the world’s poorest countries, most of which are in Africa. The G8 have agreed to a proposal to provide 100% per cent debt relief to the poorest countries in the world. This is worth $40 billion and could reach $50 billion as more countries qualify. Writing off $17 billion of Nigeria’s debt is a major component in debt relief.

The World Bank IDA deputies have agreed to the financing that exceeds the threshold they initially set for funding debt relief. The deal reflects firmer commitments for most countries.
Initially, 17 HIPC countries were eligible for 100 percent debt cancellation these include: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda and Zambia. Mauritania had already completed the HIPC program, but will qualify for relief after implementing key public expenditure management reforms. The remaining HIPC countries will be eligible for debt cancellation once they have completed the requirements of the HIPC Initiative.

Donors have agreed to a financing package that calls for additional donor contributions over time to ensure delivery of fresh resources for poverty reduction. Compensatory financing over the duration of the cancelled loans will be based on strong indicative pledges already made, and donors are undertaking the necessary steps in their home countries to provide their financing commitments.

A commitment has been made to end all agricultural export subsidies by 2013 as agreed in the World Trade Organization’s Ministerial in 2006 and to end cotton subsidies by the end of 2006.

This degree of scaling up of ODA resource allocation gives Africa a real opportunity to meet the MDGs provided a concerted effort can be made to improve the quality of that aid.

The following preliminary data give a picture of the start towards honouring the commitments made shown in Table 3.0. The complete data on what happened according to OECD and DAC is expected to be released in December 2006. What can be observed so far is an indication of the direction of change in 2005 compared to 2004. Official development assistance to developing countries from member countries of the OECD recorded a new high of 31.4 per cent to US$ 106.5 billion in 2005. It represents 0.33 per cent of the Committee members' combined Gross National Income in 2005, up from 0.26 per cent in 2004. The indications so far are that the direction of change is the right one and the pace of change is promising. In 2005/6 UK fulfilled the commitment to provide BP1 billion to Africa and committed to provide BP 1.25 billion to Africa in 2007/8.

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G7 COUNTRIES | 80068     | 57578    | 78920    | 37.1       |
NON-G7 COUNTRIES | 26409 | 21976 | 25617 | 16.6    |

NON DAC COUNTRIES

Czech Republic | 131      | 108      | 122      | 12.6       |
Korea          | 744      | 423      | 665      | 57.1       |
Poland         | 283      | 118      | 236      | 101.12     |
Slovak Republic | 56       | 28       | 53       | 87.7       |

(1) Taking account of both inflation and exchange rate movements

Note: The data for 2005 are preliminary pending detailed final data to be published in December 2006. The data are standardised on calendar year basis for all donors, so may differ from fiscal year data available in countries budget accounts.

Source: OECD 30 March 2006.

IDA 14 has been enhanced resources available for the 81 poorest countries by 25% to $33 billion during the next 3 years. Of this amount $18 billion is new contributions from 40 donors. The African development Bank’s 10th replenishment of the Africa Development Fund (the concessionary arm) has been enhanced by 40% over the previous replenishment.
Innovative financing mechanisms that have been designed and put in place can help delivery and bring forward the date for meeting the financing needs necessary to achieve the Millennium Development Goals (MDG). In this context, proposals have been made to establish the International Finance Facility (IFF), a mechanism which utilises capital market resources to provide an immediate and significant increase in development assistance. With the IFF, it is hoped that donor countries can be prompted to reach the equivalent of 0.7% ODA/GNI faster. Some countries have agreed to launch the International Finance Facility (IFF), move quickly ahead with the International Finance Facility for Immunization (IFFIm). Therefore, the IFF will make it possible to deliver additional resources earlier.

These additional resources will allow the international community to tackle development issues (such as HIV/AIDS and other health issues), which are currently increasing in scale and expense, before they become even more costly in terms of lives and financial resources. It is the case that repayments will need to be made to bondholders from future aid flows but even allowing for this, overall aid flows will continue to increase in future years due to expected increases in aid budgets and the number of donors (for instance, China is expected to become a donor in future years). It is also important to consider that the additional resources that an IFF would generate immediately would also be expected to tackle problems in developing countries, which could result in a reduction in the future needs in such countries.

The IMF established the Exogenous Shocks Facility in October 2005 to which the UK has been the first contributor to the tune of BP50million over 5 years. Seven countries pledged in September 2005 to contribute to the new UN emergency fund to help faster delivery of emergency aid. In October 2005 a new Infrastructure Consortium for Africa was established to broker funding by June 2006 to five African priority projects. The World Bank launched a new Strategic Action for Africa in September 2005. As part of this initiative a Catalytic Fund for Africa was established for African countries which can show that they are capable of using it effectively to achieve MDG goals. Some donors have started to contribute to this fund. For instance, UK has contributed BP 200 million to this fund.

Further financing facilities are being discussed. Proposals to levy an airline ticket tax have been put forward for discussion. The International Drug Purchase Facility has also been brought up for discussion.

The G8 summit agreed that it is acceptable to count debt relief efforts as Official Development Assistance (ODA) – and that debt relief will continue to be an important component of ODA. However, it is important that this recognition be interpreted in the spirit of the Monterrey Consensus indicated that it was “critical” that debt relief efforts “be fully financed through additional resources”.
Aid in the form of debt relief grants increased more than 400 per cent between 2004 and 200519, while other aid increased 8.7 per cent in the same period. This in part reflects the substantial debt relief deals agreed by Paris Club creditors for Iraq and Nigeria. In 2005 Development Assistance Committee (DAC) members provided debt forgiveness grants of nearly US$ 14 billion to Iraq and a little over US$5 billion to Nigeria. Further debt relief to Nigeria will be included in Official Development Assistance (ODA) figures in 2006 and to Iraq for the next three years as members implement further stages of the Paris Club agreements.

The World Bank’s Board of Executive Directors approved financing and implementation details for the World Bank’s contribution toward the Multilateral Debt Relief Initiative (MDRI), which will cancel the IDA debt of some of the world’s poorest countries starting on July 1, 2006, at the start of the Bank’s new fiscal year. IDA is expected to provide more than US$ 37 billion in debt relief over 40 years. This is a historic agreement combining increased financing with debt relief, which will help poor countries meet the Millennium Development Goals.

There has also been agreement of a proposal to cancel over US $50 billion worth of debt stock owed by Heavily Indebted Poor Countries (HIPC) to the World Bank (IDA), African Development Bank (AfDF) and IMF. 21 countries have already benefited from 100% IMF debt stock cancellation (19 HIPC, 15 of which are African). The Paris Club has also agreed a deal to resolve 100% of Nigeria’s Paris Club debts, including writing off $17 billion worth of debt stock. IDA and AfDF Deputies have agreed that resources pledged to compensate for the costs of debt stock cancellation will be additional to their pledges for the regular replenishments. The costs of debt stock cancellation will be clearly distinguished in future replenishment discussions and donors have agreed to use the current replenishment totals as a baseline for future contributions. Table 4.0 indicates the status of various countries and the stages they have reached towards debt relief. The criteria used to make the assessment are also indicated. This is an encouraging start in the implementation of the commitments made in Gleneagles and Paris in 200520.

Table 4.0 Enhanced Heavily Indebted Poor Countries Initiative
List of Participating and Potentially Eligible Countries

<table>
<thead>
<tr>
<th>Completion Point</th>
<th>Decision Point</th>
<th>Pre-Decision countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>19 countries Eligible for MDR1</td>
<td>12 countries</td>
<td>10 countries</td>
</tr>
<tr>
<td>Benin</td>
<td>Burundi</td>
<td>Central African Republic</td>
</tr>
<tr>
<td>Bolivia</td>
<td></td>
<td>Comoros</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>Chad</td>
<td>Cote d’Ivoire</td>
</tr>
<tr>
<td>Cameroon</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

19 Table 1.0 shows the donor fund up to the end of year 2005.
20 From African Governments standpoint, Debt relief is preferable to aid since its fiscal and BOP impact is predictable and flexible.
A major concern over the scaling up of aid has been the issue of predictability. Donors' commitments have traditionally been quite short-term and delivery has been erratic. Aid flows have as a result been volatile and difficult for governments to manage. It is also difficult for governments to contemplate long-term expansion of service delivery (health and education) under these conditions. This issue deserves to be taken up as part of the options for improved monitoring. This was a leading theme of the UK paper "From Commitment to Action" written in September 2005.

3.2 Financing Development Commitments: Quality

The G8 meeting at Gleneagles ended with a statement expressing the pledge to support sound development strategies with better aid as one way of ensuring that aid is used most effectively. Implementation would be motivated by all commitments that were made in the Paris Declaration on Aid Effectiveness. The Paris Declaration on Aid effectiveness reaffirmed the commitments made at Monterrey (2002) to scale up aid and those made in Rome (2003) on improving the quality of aid. High level commitment was made to encourage donors and partner countries to make aid effectiveness a high priority. In this context, the commitments were made in accordance with five principles: ownership and leadership, alignment, harmonization, managing for results and mutual accountability. It was agreed to reaffirm the commitments to accelerate progress in implementation.

Ownership and leadership

Partner countries agreed to work towards ownership of their development agenda and to exercise effective leadership over their development strategies and co-ordinate development actions. Partner
countries committed to exercise leadership in developing and implementing their national development strategies through broad consultative processes and to translate the national development strategies into prioritised results-oriented operational programmes as expressed in medium-term expenditure frameworks and annual budgets.

Alignment
Donors are to base their overall support on partner country development strategies, institutions and procedures and conditionality is to be based on commitments made in the respective partner country national development strategies. This would also imply strengthened public financial management and procurement systems in the partner countries.

Harmonization
Donors’ actions are to be more harmonized, transparent and collectively effective. Commitment has been made to implement the donor action plans that would have been developed as part of the follow-up to the Rome High-Level Forum and to implement common arrangements at country level for planning, funding (e.g. joint financial arrangements), disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows. It has been acknowledged that increased use of programme-based aid modalities can contribute to this effort. This would involve change of behaviour, policies and practices and adopting a pragmatic approach to the division of labour and burden sharing of responsibilities.

Managing for Results
Commitment has been made to managing resources and implementing aid in a way that focuses on desired results and making better use information to improve decision making. This is particularly important for organizing monitoring.

Mutual Accountability
Commitment has been made by donors and partners to be accountable for development results based on continued high-level political support, peer pressure and coordinated actions at the global, regional and country levels. It has been agreed to adopt the practice of making joint assessment of mutual progress in implementing agreed commitments. At present accountability requirements are often harder on developing countries than donors, yet aid is more effective when partner countries exercise strong and effective leadership over their development policies and strategies.
The Paris Declaration has created space for stronger mechanisms for accountability and promoting a model of partnership that can improve transparency and accountability on the use of development resources. It recognises that for aid to become truly effective, stronger and more balanced, accountability mechanisms are required at different levels. At the country level, the Paris Declaration encourages donors and partners to jointly assess mutual progress in implementing agreed commitments on aid effectiveness by making best use of local mechanisms. But it seems there is no agreement on who will monitor the commitments made and what will be the actions taken for those failing to meet the pledges. At the international level, the Paris Declaration constitutes a mechanism which donors and recipients of aid can be held mutually accountable to each other and compliance in meeting the commitments will be publicly monitored.

The financing commitments that have been made will only facilitate realization of desired outcomes if concrete action is taken to meet the commitments made in terms of quantity and quality. A review of progress that has been made towards meeting the commitments is made both in terms of quantity and quality of aid.

The Paris Declaration on aid effectiveness developed **twelve indicators** to monitor progress in achieving results\(^\text{21}\). The indicators of aid effectiveness were developed as a way of tracking and encouraging progress against the broader set of partnership commitments. Targets for the year 2010 have been set for 11 of the indicators and are designed to encourage progress at the global level among the countries and organisations adhering to the Paris Declaration.

The relationship between Africa and its development partners is undergoing radical change. At the centre of this new relationship is the establishment by Africans of the African Union and NEPAD (an initiative that has been incorporated into the African Union). The institutional capacity developments and strategic alliances among key African institutions have been growing at an encouraging pace recently. With these new foundations, and with the capacities available in the UN Economic Commission for Africa, the African Development Bank and the emerging active role of certain sub-regional bodies, Africans themselves are taking charge of defining, analysing and meeting the major challenges facing the continent. These issues range from governance, peace and security to economic and social modernisation, to defeating pandemic diseases – and the roles that women play in all these contexts. The level of engagement and the quality of policy discussion among Africans has evolved enormously over the last few years in all these areas. African countries are now more committed to good economic governance through improved macroeconomic stability, public finance management, accountability, resource mobilisation and financial and monetary institutions. The locus of intellectual work on African problems is in the process of shifting from international institutions and institutes to Africa. These are strong signs of genuinely African ownership of its political and economic development.

\(^{21}\) The Paris Declaration indicators are shown in Annex A below.
Africa has made encouraging progress in the area of governance. The 2005 *African Governance Report* identifies ten priority areas for action in building capable and accountable states. These are: strengthening the capacity of Parliaments to perform their core functions; deepening legal and judicial reforms; improving public sector management; improving the delivery of public services; removing bottlenecks to private enterprise; tapping the potential of information and communication technologies; fostering credible and responsible media; maximising the contribution of traditional modes of governance; confronting the governance dimension of HIV/AIDS; and getting partners to live up to their commitments. In this regard, the African Peer Review Mechanism introduces analysis and review of African performance by Africans, which has demonstrated that Africans can take responsibility for monitoring their own behaviour on their own terms and at their own initiative.

In this regard, the NEPAD agreement to launch a biennial *Mutual Review of Development Effectiveness*, and the endorsement of this process by the OECD, is important decisions, on both sides, to embed the new relationship in a concrete process of technical and political level interaction. In this context, the *Mutual Review* has been established as a consultation mechanism between Africa and OECD countries, designed to assess and monitor progress in delivering on commitments and achieving goals. It involves a series of discussions at expert and political levels in various international fora based on the “Executive Package”, which covers a review of commitments that have been undertaken, the main messages emanating from the analysis and assessment of recent developments, identifies the action frontiers where greater efforts are required, and addresses performance benchmarks, which will be monitored in the next *Mutual Review* process. Cases where progress has been made such the decision by UK to reform its approach to conditionality whereby aid is no longer conditional on specific policy decisions by partner governments should provide useful lessons to the process.

The mechanisms that have been set up in the context of the African Partnership Forum for monitoring and advancing implementation of commitments and using the Joint Action Plan of Commitments by Africa and the development partners is an encouraging step in the right direction. The Africa Action Plan (AAP) is the basis on which G8 commitments to Africa and to the New Partnership for Africa’s Development (NEPAD) have been monitored since 2002, when the AAP was agreed at the G8 Summit in Kananaskis, Canada. The 2003 G8 Summit in Evian developed the G8/Africa political relationship further by establishing the APF. The APF meets twice yearly, and consists of representatives from the G8, from African countries, international institutions and Organisation for Economic Co-operation and Development (OECD) donors who give over $100m to Africa in Official Development Assistance (ODA) each year.

In October 2005 the EU launched a new partnership with Africa in which working groups will step up their work with implementing the Paris declaration. The work that is being planned for SPA7 has the potential to improve the partnership relationships that are so essential to increasing aid effectiveness.
The structure agreed so far is that of having three Working Groups, one for budget support, one for sector support and one for capacity development. These Working Groups will have Co-Chairs representing both the donor partners and the African governments who are SPA members.

A positive development in monitoring is the launching of the DAC Monitoring Survey on 2\textsuperscript{nd} May 2006 that has great potential to establish an initial and comprehensive baseline against which progress can be monitored. This will be an important step to help governments and donors jointly to identify how to operationalise Paris Declaration commitments at country level. The DAC plans to issue its final report in November/December 2006. Countries who signed up to the Paris declaration will not automatically be included - they have to nominate themselves to take part and so far very few have. So far 12 countries have confirmed their participation in the survey. The benefits of this survey include: encouraging a broad based dialogue at country level on how to make aid more effective; providing an accurate description of aid flows at country level; and empowering partner governments to put uniform pressure on other donors in a way which is backed up by the Paris Declaration commitments and agreements on indicators and targets.
4.0 IMPROVING MANAGEMENT OF AID FOR DEVELOPMENT

The impact of aid and its effectiveness can be influenced by the way aid is managed. The Marshall Plan for the reconstruction of Europe was managed to work effectively, in East Asia aid to South Korea and Taiwan worked effectively and in Africa aid to Botswana and Mauritius has been a success (Lancaster and Wangwe, 2000 and UNCTAD, 2006). These experiences indicate that aid management is important in ensuring that it plays the intended role in development including successfully graduating from it. Some reflections are made here in respect of aid regimes and the associated norms, principles and rules and procedures and reference is made to the emerging regime in which partnerships, ownership, holistic frameworks are being revisited. This chapter will also examine the changing context, redefining partnerships and promoting ownership, improved coordination, enhancing capacity building and capacity to manage change, reducing transaction costs by improving aid delivery mechanisms and donor policies and practices and improving budget management systems and managing the exit strategy.

4.1 The Changing Context of Development and Partnership in Development

Donors have recognized that using conditioned lending, in effect, to force African governments to implement such reforms, is not likely to have a high success rate. Thus, while not abandoning the notion of aid tied to reforms, donors have begun to explore ways to reshape the way they do business. A new regime is emerging and it involves commitments on the part of aid donors to four elements: selectivity, participation, ownership, and developing new modalities for managing the aid. These elements are being shaped within the broad conceptual context of the Comprehensive Development Framework (CDF) proposed by the World Bank. The CDF is a template intended to include the numerous and diverse elements – economic, political, social, even cultural – that can play a role in development, broadly defined. Following on the CDF and international poverty reduction goals agreed in the DAC in 1995, a number of developing countries, with the support of the World Bank, have also produced Poverty Reduction Strategies to guide government policies and investments (including aid-funded investments).

The new aid regime is emerging in a new context in several ways as indicated by recent developments on the development partner side and on the Africa side. There is greater interest in poverty reduction, the end of the Cold War is changing alliances and partnerships, international peer pressure is being

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applied to improve aid effectiveness and initiatives are being taken to forge new partnerships between
donors and recipients and within recipient countries partnerships with various actors are being
redefined.

First, the poverty focus as expressed by OECD (1996), the World Bank’s Comprehensive Development
Framework and the increasing adoption of poverty reduction strategies in Africa is a major departure

Second, the end of the Cold War will not end the importance of foreign policy and donor interests in
influencing aid allocations but it may reduce the preponderance of aid allocations along the old
ideological lines. In this situation, even new criteria for aid allocations have a better chance of being
considered and put into practice.

Third, international peer pressure is being applied to improve aid effectiveness including harmonizing
aid delivery mechanisms. The initiatives that are currently being taken in OECD through the DAC and
SPA processes as well as initiatives taken under the UN system are encouraging.

Fourth, initiatives are being taken to forge partnerships with private international capital such as public-
private participation in infrastructure investments.

Fifth, the trend towards political liberalization and democratization in Africa and endorsement of efforts
to achieve good governance at the Pan-Africa level, as in the Africa Union and New Partnership for
African Development (NEPAD), are indications that Africa may be rethinking its approach to
development management. The new approach to development is slated to be more inclusive and
participatory and more amenable to accountability to the local stakeholders. In the NEPAD framework,
for instance, Africa views assistance from development partners as supplementing Africa’s own
undertakings and efforts.

4.1.1 Redefining Partnership and Promoting Ownership

There is increasing concern about the need to redefine aid relationships with a view to attaining a more
appropriate balance consistent with greater ownership by recipients of aid. Tough choices will need to
be made by both sides of the development partnership. African governments will have to adopt better
economic policies and open up their governance systems while donors will need to reform their policies,
regulations and procedures. In the international economic system reforming African governments need
greater space trade and accessing markets. Aid relationships and appropriate forms of partnerships will
need to be redefined as has been stressed by OECD (1996, 2001, 2003), World Bank (2003), Paris
declaration (2005) and NEPAD (2001). Opportunities for improving aid relationships and for fuller
implementation of the CDF principles are found in a number of recent initiatives such as NEPAD,
Monterrey Consensus, the Rome Declaration, Paris Declaration (2005), harmonization work of the SPA,
development of a Millennium Development Strategy and the World Bank’s initiative on monitoring and measuring of results.

It is also increasingly recognized that the behavior of aid donors is a factor in the aid effectiveness equation in Africa (Lancaster and Wangwe, 2000). Ownership of the development agenda, policy and programmes is a critical factor in realizing aid effectiveness in a sustainable way.

During the period of economic reforms many countries made improvements in the soundness of their macroeconomic policies but at the same time ownership of the policy agenda was eroded considerably.

It has been argued that today’s concerns about development partnerships fall short of addressing the problems of coordination, ownership and dependence (Kanbur et al, 1999). What is needed is a more radical approach in which the recipient country would first develop its own development strategy, programmes and projects, primarily in consultation with its own population but also in dialogue with donors. It would then present its plans to the donors who would put unrestricted funding into a common pool (Kanbur et al, 1999). The common pool of development assistance together with the recipient’s own resources would then finance the overall development strategy.

As regards country ownership it has been shown that governments and donors have expanded consultations especially within the executive branch and among selected CSO representatives but the consultations have remained narrow among wider public through their elected representatives such as Parliament, mainstream CSOs and the private sector (World Bank, 2003 and Paris declaration, 2005).

4.1.2 Towards Country-led Development

It is increasingly recognized that the behavior of aid donors is a factor in the aid effectiveness equation in Africa. Donor driven aid -- where aid agencies rather than recipient governments identify projects and programs, design, implement and evaluate them -- has been a problem in Africa, reducing both the quality of aid-funded activities and the sense of responsibility for ensuring that those activities are effective and sustainable on the part of the recipients of the aid. Progress on country-led partnership has been uneven across donors, countries, sectors and across dimensions of the country-led principle. Effectiveness of country-led partnership has been undermined by political economy challenges (interest groups) in some donor countries and by the slow progress towards good governance and capacity building in many recipient countries (World Bank, 2003). Under these circumstances, there has been slow progress towards aligning country assistance strategies to national development strategies in recipient countries, capacity building with a long term perspective, sharing of information, greater

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selectivity of donor-funded activities and harmonization of donor procedures and practices. A promising opportunity has emerged on the harmonization of donor procedures and practices as expressed in the Rome Declaration on Harmonization (February, 2003) which has called on donors and recipients to act on two fronts. First, to utilize and strengthen existing mechanisms to maintain peer pressure on implementing harmonization agreements. Second, to conduct stocktaking meetings in early 2005 in order to contribute to the review of the Monterrey Consensus implementation. The Monterrey conference highlighted the importance of building partnerships among donors and developing countries as a means of making more effective progress towards the MDGs (OECD, 2003). It called on development cooperation agencies to intensify their efforts to harmonize their operational procedures at the highest standard with a view to reducing transaction costs and increasing flexibility in aid delivery. High transaction costs are manifested in administrative cost and capacity in meeting multiple donor requirements, eroding ownership or preventing its development and eroding the capacity for effective public management.

According to a recent evaluation by the World Bank (2002), well-allocated aid has been an effective means of supporting poor countries and poor people and with improved allocation and better design and delivery of assistance, aid is more effective today than ever before. The evaluation concluded that aid is most effective when recipients are the primary drivers of their own reforms and institutional development and that advice and capacity building provide an important complement.

A recent evaluation by the World Bank (2003) has shown that both donors and recipients have made progress in implementing CDF principles, particularly in countries where these principles have been implemented for some years now. It was found that the four principles of CDF have largely been operationalized through the PRSP process which also emphasizes: long term and holistic vision, country ownership, results orientation and country-led partnership. There are practical benefits, especially in terms of widely-owned and better-targeted public expenditure programmes. The most radical change needed at present is by donors. Overall, it was observed that the CDF principles are about changing behaviour, norms and institutional practices and all these take time and require transparency and mutual trust of all parties.

The report found that the progress in implementing the results orientation principle has been the most illusive of the four CDF principles largely due to weak technical capacity, data limitations and lack of sufficient demand for monitoring and evaluation (World Bank, 2003).

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In the case of Tanzania reasonable progress has been made to redefine aid relationships and partnerships. The Poverty Reduction Strategy paper (PRSP) process came at a time when discussions on redefining partnership between Tanzania and its development partners was fairly advanced. The new framework for relationships with the development partners is contained in what has come to be known as “Tanzania Assistance Strategy (TAS)”. TAS is essentially medium-term framework for promoting local ownership and development partnership. It seeks to promote good governance, transparency, accountability, capacity building and effectiveness of aid. TAS is essentially about a process of change in aid relationships. TAS presents a three-year strategic national framework articulating four main issues: the national development agenda, the policy framework, best practices in development cooperation and indicators for monitoring its implementation. In practice, there has been some adjustment of aid policies in terms of changing the pattern of aid delivery in response to the PRSP. Initiatives have been taken to put in place an institutional arrangement to monitor the process of change of aid relationships. Since February 2002 an Independent Monitoring Group acceptable to both government and donors has been appointed and given the mandate to monitor progress in aid relationships and report to the Annual Consultative Group meetings. This is one promising example of the way forward in terms of redefining aid relationships. The origins and developments in redefining donor relationships are described in greater detail in a book “NEPAD at Country Level: Changing Aid Relationships in Tanzania” published by Mkuki na Nyota Publishers in Tanzania and distributed by African Books Collective.

4.1.3 Coordination

Coordination of aid is another factor of aid effectiveness. The presence of large numbers of aid agencies -- numbering as many as 40 in many countries -- which tend to operate in diverse and poorly coordinated ways that increase transactions costs to already over-stretched governments and further diminishes the effectiveness of aid. This puts a challenge on developing strategies of aid coordination under these conditions. Effective and sustainable aid coordination must be led by the African countries with clear identification of priority areas and indicators. In this sense coordination will be consistent with enhanced ownership and will represent an extension of ownership.

4.1.4 Capacity Building and Capacity to Manage Change

The impact of aid -- especially relatively large amounts of aid -- is mediated through the organizations that manage it and the institutions that it affects. The capacity of these institutions and the human resources for running them often falls short of requirements. There are two approaches to this problem in the context of Africa. The first approach is one which posits a pessimistic view about the capacity of Africa and donors to change their ways of managing aid and their capacity to improve governance and management of development. According to this approach, institutions are problematic, as they frequently are in Africa, the aid can undercut rather than hasten development. Since reforms involving
the management of large amounts of aid cannot be implemented effectively, the policy proposal for both donors and recipients of aid is to reduce the amount of and dependence on the aid. The second approach is one which posits an optimistic view about the capacity of Africa and donors to learn from past failures and change their ways of managing aid and improve governance and management of development. It is only if aid is effective that more of it can be justified in the initial phases in order to build the capacity to manage the economy and manage a transition towards less aid in future. The implication is that aid management needs to change considerably from past practices on the part of recipients and donors alike. The interaction between aid and institutional learning by the recipient is important and should be cultivated in a way that it is used to promote institutional capacity building rather than capacity erosion. It is this second approach that is recommended for the way forward in Africa.

Collier (2002)\(^\text{27}\) has identified three ways in which aid effectiveness, which he calls making aid smart, can be realized. These are:

- Allocating aid selectively to countries where policies, institutions and other conditions make it most effective and by avoiding countries where aid is likely to be ineffective or even counter-productive. In fact, Collier and Dollar (2002)\(^\text{28}\) have shown that reallocation of aid can double aid effectiveness in poverty reduction by targeting countries in severe poverty while having reasonable policies and institutions. It is also proposed that aid should be targeted for severe external shocks, post-conflict situations and for conflict prevention.

- Use aid to promote reform not through old-style conditionality but by strengthening the capacity of society to reform itself.

- Use aid to finance basic services in the most needy environments. Collier proposes the construction and supervision of an Independent Service Authority, as an effective wholesaling organization which would be delivering a flow of services rather than a flow of projects.


4.1.5 Reducing Transaction Costs: Improving Delivery Mechanisms and Donor Policies and Practices

Effectiveness of aid is influenced by aid delivery mechanisms. The way forward is to shift towards greater flexibility in aid allocations with a view to adjusting and adapting to changing performance. In this context, the case study of Tanzania has shown that towards the end of the 1970s and early 1980s it increasingly became clear that value-added from new investments was limited because of the declining capacity to import the needed intermediate inputs and to meet other recurrent expenditure requirements at a time when both the balance of payments and budgetary deficits were growing. Given the situation of low or negative marginal contribution of new investments, it was also perceived that aid allocated to new investments was not effective in increasing output as the recurrent budget requirements (in terms of local currency and foreign exchange) were beyond what the economy could bear. In response to this situation deliberate efforts were made to shift from project aid to import support and financing of rehabilitation of existing capacities. However, by the mid-1980s the expected improvement that was expected to come from the shift towards rehabilitation of existing capacities and import support (or balance of payment support) was not forthcoming. The little momentum was quickly running out of steam. This outcome confirmed that there were more fundamental structural and policy issues which were not being addressed by changing forms of aid. As a shift is being made from project to programming approach coordination and management of the funding mechanisms will continue to pose a major challenge in order to make progress in transparency, flexibility, predictability, policy based (along the principles of PRSP) and towards evolving common reporting and accounting procedures.

A survey that was designed and conducted by DAC Task Force on Donor Practices found that the leading burdens on recipient countries have been identified as donor driven priorities and systems, difficulties with donor procedures, uncoordinated donor practices, excessive demands on time and demands beyond national capacity, delays in disbursements and lack of information (OECD, 2003). The main finding substantiated by the survey is the lack of national ownership defined as partner government’ ability to design and manage its own development plans while relying on development assistance. The survey identified key areas where respondents felt reforms would most contribute to improving aid effectiveness as follows: simplify procedures and systems, harmonise procedures, align procedures to partner systems, share information, untie aid, respect national priorities and strategies, strengthen local capacity, use a coordination structure, budget support and SWApS.

The DAC Task Force on Donor Practices was established in December 2000 for a two-year period with the objective of strengthening ownership through identifying and documenting donor practices which could reduce the cost of managing aid and reduce the transition costs involved. The Report of the Task
Force indicated that good practices cover three broad functional areas where donors can enhance their procedures (OECD, 2003). These are:

- Good practices between donors and partner governments. These might include greater reliance on partner government systems of administering aid or timing missions in agreement with the agenda of the government.

- Good practices between donor agencies which aim preventing unnecessary duplication of work both for partner governments and donors.

- Good practices within individual donor systems. These entail changes that donors can make to their own systems and culture to permit the strengthening of recipient country ownership and reduce the cost of managing aid.

Specific good practices have been summarized under the framework for donor cooperation by OECD (2003) as follows:

- Donors prepare their country programmes in collaboration with partner governments to ensure consistency with national plans and strategies and share these with key stakeholders.

- Donors programme aid over a multi-year time frame, agree on common performance indicators and review processes and provide full information on aid flows.

- Donors provide budget support and agree on a common conditionality framework based on the partners’ development strategy and aligning the timing of commitments and disbursements to partner government cycles.

- Donors consult partner governments and share information about joint donor-donor working, negotiating specific common country procedures and global procedures are pursued only where they do not undermine adoption of partner government systems.

- Donors encourage collaborative and flexible behaviour and roles and responsibilities of donor agencies made clear to all key stakeholders.

The evaluation conducted recently Towards Country-led Development World Bank (2003) has suggested three areas that would benefit from expanded learning efforts:
• How to establish country-owned and innovative monitoring and evaluation systems that bring stakeholders together.

• How to start a debate in donor countries about agency incentives, public attitudes towards aid, pooling resources and results and the role of audit offices and treasuries in compounding the problem.

• How to replicate the positive lessons of experience among recipient countries such as Uganda’s experience with MTEF and Tanzania’s experience with Independent Monitoring.

4.1.6 Improving Budget Management Systems

The report found that long-term development frameworks have operational meaning only if they are translated into a disciplined budget process as a framework for allocation of resources, a basis for country-led partnership and a framework for assessing results (World Bank, 2003). This implies that operationalization of long term frameworks will be realized if donors provide predictable and reliable budgets. Lensink and Morrissey (1999) found that when uncertainty of aid is taken into account aid is found to have a significant positive effect on growth, largely due to its effect on the volume of investment. The finding that uncertainty reduces the effectiveness of aid is robust. This suggests that stability in donor-recipient relationships could enhance aid effectiveness, by making it easier for recipients to predict future aid flows that may in turn permit more investment and better fiscal planning.

There is need to improve budget management systems. One prerequisite for this improvement is that the record of transactions must be reliable. Situations where a large part of the aid flows are not captured in the budget are likely to be associated with low levels of budget management and accountability. In many countries in Africa, donors do channel a large part of aid resource flows through the Exchequer. In the case of Tanzania, for instance, 50% of aid still is channeled outside the budget down from 70% two years ago (Wangwe, 2001). This means that 50% of the assistance bypasses the normal approval procedures including the legal procedures. This practice has important implications on undermining coherence of the poverty focus and weakening the reporting system and accountability over resource use.

Improvement of budget management deserves high priority. Accountability and monitoring will need to be improved as an important part of budget management. Four aspects of monitoring and accountability can be identified in this context. First, it was suggested that this will entail improving the availability of appropriate information on public finances with emphasis on timely recording and reporting of public expenditures in a form which is conducive to monitoring by the various stakeholders. Second,

29 Robert Lensink and Oliver Morrissey. Aid Instability as a Measure of Uncertainty and the Positive Impact of Aid on Growth. CREDIT. University of Nottingham, 1999.
expenditure studies in various countries have revealed that only a portion of allocated funds actually reaches the envisaged destination. It is recommended that these expenditure-tracking activities need to be institutionalized (moving from studies to systems of expenditure tracking). Third, consistent with result orientation, it is recommended that the concept of auditing of public expenditures should be broadened to cover both technical auditing and auditing for effectiveness (value for money). Fourth, it important to recognize that the concept of monitoring and accountability is not only a technical matter but is also deeply rooted in the political economy and governance obtaining in a country. In particular, it is recommended that efforts to fight corruption need to be part of the effort to improve accountability and monitoring of the public finances. The fight against corruption needs to be a joint effort between the African countries and the development partners considering that often collaborating individuals in corruption originate from both groups of development partners. Efforts made by African countries to fight corruption and efforts made by OECD countries to legislate against bribery (which has been passing as commissions) are welcome and should continue.

The budget process deserves greater attention than has been the case in past. In particular, the need to build the capacity for budget management and policy coordination is an important aspect of paving the path towards good policy making.

Greater participation in the budget process by various stakeholders is expected to influence allocations of public expenditures and improve accountability of expenditures.

There is need to guard against the possibilities of reversals in progress made to enhance aid effectiveness. Mechanisms for determining aid effectiveness need to be institutionalized and locked-in so that they are sustainable and difficult to reverse. As regards the accountability of financial resources at local levels, Courtnage (2001)\textsuperscript{30} has made reference to the case of Uganda where tracking expenditures has been institutionalized. The system has been put in place whereby the public is made aware of the resources and tracks the resources down to the local levels. Tanzania has also started to put this system into practice. Grants to local governments need to be more transparent with a view to reducing uncertainty and curbing inequalities.

Development of the new partnership mechanisms should also enhance the predictability of resource flows. The MTEF process which is now widely being adopted in Africa is intending to address this problem (Ndulu, 2001)\textsuperscript{31}. However, while reasonably good progress has been made in improving public financial management through PER and MTEF processes at the national level in several African countries, relatively little progress had been made at the local levels. It is recommended that these

\footnotesize{\textsuperscript{30} Courtnage, P. Contribution to the Panel Discussion Cited in AERC (2001).}

\footnotesize{\textsuperscript{31} Ndulu, B.J. Putting the Principles of Aid Effectiveness into Practice in Africa. In AERC (2001).}
processes need to be rolled out to the regional and local governments in the African countries. This would entail improvements in terms of redefining roles and responsibilities and improving public financial management at those levels (controls, recording, reporting and auditing) and building capacities in human resources.

African countries and the development partners have expressed interest to improve public financial management and accountability. What needs to be done now is to develop jointly acceptable minimum standards (e.g. of accounting, reporting) and best practices. There are several ongoing initiatives to harmonize processes of accounting and reporting (e.g. at the level of OECD/DAC, multilateral development banks). It is recommended that these initiatives need to be harmonized.
4.2 Managing the Exit Strategy

An exit strategy is necessary from two points of view. First, it is quite possible that aid could be reduced influenced by factors on the donor side. Second, the recipient country should seek to graduate from aid dependence at some point considering that the rationale of aid is to enable the recipient to stand on its own feet. This rationale should not be lost sight of.

It is important that African countries begin to consider what policies to adopt to implement an exit strategy and manage a smooth reduction in aid dependence over time even if in some cases a higher level of aid dependence may be warranted in the initial phase of the transition. A reduction in aid dependence should be anticipated and a strategy for managing the transition from high levels of aid dependence to less aid dependence should be put in place. The challenge is to formulate a strategy which would be consistent with a decrease in overall aid inflows in the future. The exit strategy should enable aid dependent economies to diminish their dependence on that aid without disrupting their economies or deepening their poverty.

Broadly speaking, strategies for managing a smooth transition from aid dependence in Africa, depend on the capacity and commitment of African governments to development as suggested by Lancaster and Wangwe (2000).

• **Countries with governments that are both capable and committed**

These countries should be able to handle relatively large amounts of aid well. The strategy for reducing their aid dependence would be for aid to rise for a period as needed and then, as less external concessional assistance is required, to taper off. The degree of aid dependence and period of time over which that dependence will increase and then decreases will depend on the needs of the particular country.

• **Countries with governments that lack both capacity and commitment**

Where these countries are aid dependent, donors will want to implement a strategy of gradually reducing that dependence until a government with a strong commitment to development appears. Aid in the form of development ideas and capacity building may be more appropriate in such cases.
• Countries with governments that have limited capacity but a significant commitment to the development of their people

Here, the broad outlines of a strategy for reducing aid dependence might include an emphasis on strengthening the capacity of the government and civil society organizations and on adjusting the levels of aid and, above all, the management of aid, to amounts the recipient government can handle effectively.

Lessons can be drawn from cases of successful initiatives towards reducing aid dependence. Botswana provides a unique case study of aid dependence in Africa. It has gone from being one of the poorest, most aid dependent countries to a middle-income country no longer in need of significant amounts of external assistance and where donors have begun to phase out aid. Several factors explain Botswana’s positive experience with aid. First and most important, the Government of Botswana has been competent, clean, disciplined and effective in managing its economy. It has been able to plan and implement economic policies and programs effectively for growth. More broadly, governance in Botswana has been effective and the political system stable. A second major factor underlying the positive consequences of aid dependence in Botswana is that the government has managed its aid effectively making sure that aid supported projects fit into the national development framework. Most importantly, the government has proved capable of integrating aid into its broader development plans and priorities, and it has been willing to reject aid that did not fit those priorities. Prudent management of the economy has also meant that the state has successfully managed to mobilize domestic resources including those from the extractive industry and the collected revenues have been utilized to undertake investments in human and physical infrastructure. In addition, to attract the foreign investment that would develop the mineral resources, the government built the needed infrastructure - again, with the help of foreign aid.

A strategy for managing a smooth transition from aid dependence will thus vary significantly from country to country, depending on its needs, capacity and commitment. In some countries, it may make sense to plan for immediate increases in aid (where capacity can be quickly strengthened), followed by a decrease in aid dependence in the future. In some countries, the emphasis in the near term will be on improving capacity.
4.2.1 Enhancing the Capacity to Attain Development Goals

There are two major concerns in a strategy of reducing aid dependence, the priority of each depending on the specific circumstances of the country in question. One relates to the achievement of the MDGs and the other relates to the distributional impacts of aid reduction.

(i) The first concern is about realizing the millennium development goals (MDGs). For instance, concern has been expressed about the adequacy and maintenance of key social services -- primarily education and health services. Where the reach of primary education and health care is extremely limited -- for example, where half of fewer of the eligible age group is in primary school -- it may make sense for aid donors and recipient governments to agree on achieving target levels of services, to increase aid for a short period to help governments reach those targets and then to reduce overall aid levels and aid dependence. The decisive factor here is whether the recipient government can manage the temporary increase in aid to achieve agreed goals and whether it can maintain those achievements (involving their organization and financing) once aid is reduced. In order to attain the international development goals and the millennium goals the way forward must address the quantum of resources, how these resources are allocated and how effectively they are utilized. Many have argued that large amounts of aid over an extended period of time can help lift poor countries out of poverty. Amoako and Ali (1998) have made estimates of resource requirements if development in Africa is to reduce poverty levels by half by 2015 and yet be able to reduce aid dependence. They have found that it is feasible provided that substantial external support is provided in the initial phase. Similar concern about resource requirements for achieving MDGs have been expressed in respect of all developing countries indicating that more resources in terms of ODA flows may be necessary for the MDGs to be attained. According to the Zedillo report (UN, 2001) an additional $50 billion in ODA flows would be needed to enable developing countries achieve MDGs. Devarajan et al (2000) have used two different approaches one based on growth rates and investment rates required to meet MDGs and the other is based on costs of achieving the

MDGs individually. Both approaches yield comparable estimates ranging from $40-60 billion per annum in additional ODA to achieve the MDGs.

(ii) The second concern is the distributional impact of a reduction in aid and aid dependence. Where the aid is spent nationally, it likely provides some benefits for the poor -- for example, direct services available to them, jobs, increased demand for their products and so on. Reducing aid can diminish these benefits and set the standard of living of the poor back. A strategy for reducing aid and aid dependence needs to consider the extent and impact on the poor of aid reductions and possibly methods for minimizing that impact -- for example, protecting government expenditures that benefit the poor, providing offsetting programs and expenditures, creating social safety nets and so on. In cases of high levels of poverty, the case for increasing levels of aid while reallocating a substantial part to capacity building may be stronger. Where aid increases in order to attain MDGs the question of distribution will need to be considered. In this context, it has even been suggested that if current trends (as of 1996) are to continue (i.e. business as usual) headcount poverty would fall from 72% in 1996 to 64% by 2015 Collier (2001). In order to halve poverty to 36% by 2015 Collier has gone further to argue that to attain action is required on three fronts and by different actors. First, it requires action by donors in reallocating aid towards poor countries (estimated to reduce poverty by a further 8 percent points to 56%). Second, it would require policy improvement to be effected by African countries reducing poverty by another 11 percent points to 45%. Third, it would require donors to increase the volume of aid to reduce poverty to 36% by 2015. The policy implication here is that there is need to lobby for policy improvement, aid reallocation to poor countries and more aid to Africa especially now that aid the impact of aid is reasonably good and is getting better. The increase in aid would essentially be made in the context of a clear exit strategy towards less aid dependence within a specified number of years, notably on attaining the millennium goals. The way forward is to measure performance in a comprehensive manner including taking account of external shocks. In the framework of PRSPs a comprehensive performance indicators are being developed by several countries in Africa. These performance indicators should be agreed upon among the key development partners.

The possibility of increasing the volume of aid in the initial period in order to build capacity for reducing aid dependence while realizing the MDGs has raised the challenges of absorptive capacity. The impact of aid -- especially relatively large amounts of aid -- is mediated through the organizations that manage it and the institutions that it affects. There are two approaches to this problem in the context of Africa. The first approach is one which posits a pessimistic view about the capacity of Africa and donors to change their ways of managing aid and their capacity to improve governance and management of
development. According to this approach, institutions are problematic, as they frequently are in Africa. Under conditions of limited absorptive capacity, the aid can undercut rather than hasten development. Since reforms involving the management of large amounts of aid cannot be implemented effectively, the option to be adopted is that of reducing the amount of aid consistent with the absorptive capacity. The second approach is one which posits an optimistic view about the capacity of Africa and donors to learn from past failures and change their ways of managing aid and improve governance and management of development. Reduction of aid dependence is likely to be realized if existing aid is made to be more effective. Aid effectiveness is necessary for aid dependence to be reduced. It is only if aid is effective that more of it can be justified in the initial phases in order to build the capacity to manage the economy with less aid. The map between aid effectiveness and aid dependence can be determined in the context of specific structural conditions relating to how the aid is used and the prevailing donor-recipient relations. The implication is that aid management needs to change considerably from past practices on the part of recipients and donors alike. The interaction between aid and institutional learning by doing by the recipient is important and should be cultivated in a way that it is used to promote institutional capacity building rather than capacity erosion. According to this approach, an exit strategy may not exclude an increase in aid flows in the initial phases as an integral part of the strategy for managing the transition from aid dependence. The role and pattern of aid expenditures will be a significant break from the past. This time being part of an explicit exit strategy. The approach taken here is in line with the second approach than to the first.

4.2.2 Debt Relief

If aid agencies and African governments are to collaborate successfully in a plan for reducing aid dependence in the region, a reduction in the burden of debt servicing must be part of that strategy. The latest developments in the HIPC Initiative have linked debt relief to poverty reduction. HIPC-1 and HIPC-2 have gone a long way towards improving the debt relief situation in Africa. However, it has increasingly been recognized that debt relief under HIPC has been coming too slowly and too little in practice. In particular, serious concerns remain about the persistence of poverty and whether the Millennium Development Goals can be achieved without enhancing further debt relief measures. This has meant that potential beneficiaries would qualify for debt relief if they prepare acceptable policy documents known as Poverty Reduction Strategy Papers (PRSP). It further requires the preparation of these strategy papers to be participatory. The conditions are meant to improve the quality of poverty reducing policy making and enhance governance. This is a positive development, but it is too early to evaluate comprehensively the effectiveness of the broadened and deepened HIPC Initiative.

Recent developments indicate that there are imperatives for debt relief. These imperatives include concerns over peace, poverty and morality, new challenges of HIV/AIDS and the need to achieve
MDGs. There are also opportunities for reversing capital flight, revisiting debt sustainability and building local capacities.

Many countries in Africa still need deeper debt relief and a further opportunity to reestablish the sustainability of their debt in the light of deteriorated conditions such as decline in exports and other shocks. Sustainable debt relief should address not only the magnitude and speed of debt relief but also the issues of debt management, fiscal sustainability including domestic debt and publicly guaranteed private debt, long term financing for sustainable development including domestic resource mobilization and ODA flows and their effectiveness as well as measures to address shocks and other special obstacles afflicting African economies.

The experience of those countries which have reverted back to debt suggests that further consideration should be given to introducing safeguards against such reversals and putting in place some arrangements for insurance of the poor countries against unexpected shocks. Such mechanisms could include contingency financing facility in the IMF and/or ODA loans with risk sharing features.

Debt sustainability should be interpreted more comprehensively to include promotion of export growth and diversification and capacity building in debt management. In this regard, domestic policies need to be designed to be supportive to more rapid and broad based growth and these efforts should be complemented by a supportive international economic environment.

The possibility or feasibility of debt cancellation should be considered together with comprehensive debt restructuring to bring debt to sustainable levels. Future financing of HIPC should have a high concessionality level, possibly considering grant financing. A recent report by UNCTAD (2004) has argued for debt cancellation. The Report calls for placing a moratorium on debt servicing (without additional interest being accrued) pending the institution of an independent panel of experts to assess the sustainability of debt based on a realistic and comprehensive set of criteria, including those of meeting the MDGs.

The Report argues a robust economic case for a total cancellation of Africa's debt:

- Low levels of savings and investment leading to high poverty and adverse social conditions are among the biggest constraints on growth in low-income African countries;
- Continuing debt servicing by African countries would nominally constitute a reverse transfer of resources to creditors by a group of countries that by all indications could least afford this; and
- In order to ensure that Africa will be able to reduce poverty by half by 2015, in line with the MDGs, at the very least growth levels will have to double to some 7%-to-8% per annum for the next decade, the financial requirements of which are incompatible with present and projected levels of debt servicing.
The UNCTAD Report (2004) recognises that even a full debt write-off would be only a first step towards restoring growth and meeting the MDGs. UNCTAD estimates that such a write-off would represent less than half those countries' resource requirements, with the gap filled by increased official development assistance (ODA) grants as a prelude to Africa increasing the level of domestic savings and investment required for robust and sustainable growth. The report indicates that the jury is still out on whether HIPC debt relief is additional to ODA flows. New initiatives are needed to attain a clear and significant level of additionality and to prevent an unfair reallocation of future aid to HIPC debt relief.

4.2.3 Domestic Resource Mobilization

The need for African countries to mobilize domestic resources as a medium to long-term goal is widely accepted. In the past, savings rates in Africa have been low, as have investment rates. While savings performance varies between countries, African countries have lower savings and investment rates than other less developed countries. Thus policies to promote savings have a central role to play in driving growth via investment and reducing aid dependency in Africa, particularly in the face of the anticipated global reduction in aid. Identifying policies that promote savings (and policy distortions that inhibit it) should be an essential element in the strategy for the long-term development of the continent (Elbadawi and Mwega, 1998). Among the determinants of private savings are economic growth, terms of trade, fiscal and financial policies, macro-economic stability and demographic factors. However, for most low-income African countries, it is generally recognized that a significant autonomous increase in the domestic savings rate is not feasible as way of accelerating growth. Rather efforts would need to be directed at increasing output, income and aggregate savings by greater utilization of existing resources, and by improving the allocation, quality and efficiency of investment.

4.2.4 Attracting Foreign Direct Investment

Foreign Direct Investment (FDI) is the predominant form of capital flows to low and middle-income countries with insufficiently developed capital markets. FDI plays an important role in sustaining equity-financed capital investments, contributes to technology spillovers through learning by doing, leads to improvement in productivity and facilitates the transfer of human capital skills.

Major steps should be taken by African countries to eliminate those factors that inhibit the flow of FDI including the maintenance of a supportive macro-economic policy environment, increased liberalization of markets and trade regimes, business facilitation and improvements in the regulatory framework for private investment.
4.2.5 Reverse Capital Flight

Capital flight refers to large private capital outflows from developing countries. It is a problem in as much as the outflows represents major macro-economic problems for those countries. There are serious negative consequences of capital flight. First, any amount of money sent away to foreign lands cannot contribute to domestic investment. Thus capital flight is a diversion of domestic savings form domestic real investment. Second, income and wealth generated and held abroad are outside the purview of domestic authorities, and therefore cannot be taxed. Thus potential government revenue is reduced, thereby constraining project execution and debt servicing capacity (Ajay, 1992). Third, income distribution is negatively affected by capital flight. The poor citizens of African countries are subjected to austerity measures in order to pay for external debt obligations to international creditors.

The challenge lies in establishing a stable macro-economic environment, avoiding an overvalued exchange rate, maintaining free access to foreign exchange through the market system, and maintaining a trade liberalization policy, where high tariffs and subsidies are eliminated. Capital flight form Africa also has political dimensions that must be addressed. There is anecdotal evidence that some African leaders and government officials through the perquisites of their offices operate huge, foreign currency denominated accounts outside their countries which is tantamount to abuse of office. The time has come for transparency and good governance whereby those who illegally acquire such assets should not be allowed to circumvent the due process of law.

4.2.6 Closing the Foreign Exchange Gap

The foreign exchange gap, which is usually filled by aid, can be closed in a sustainable way by increasing export earnings. In a competitive world, export development must entail development of the capacity for international competitiveness and diversification of exports into more technological dynamic products. African governments should come out with clear policies to support export promotion, addressing problems related to legal and regulatory framework, lack of institutions to provide leadership and stewardship over the export development function, physical infrastructure constraints, financial infrastructure constraints, and lack of capacity. There is also need to adopt policies that encourage investments and utilization of science and technology and innovations so as to continuously raise productivity. There is also need to promote linkages between local and foreign firms in partnerships that can conduce competitiveness. In this context, aid resources can be shifted towards promoting investment and trade by appropriate firm linkages and partnership.

Aid in the context of a more liberalized world economy poses several challenges:
• The volume of trade has increased globally but some countries especially the low income countries in Africa have lost out in terms of their trade shares. The challenge is whether aid can be used to facilitate reversal of this trend and put these countries on the track of increasing trade. These countries will incur costs in making the necessary adjustments in their economies that are needed to build the capacity to be competitive. Aid may be used to finance these adjustment and capacity building costs.

• Aid may be used to compensate low income countries that may lose out in the liberalization process.

• Aid may be used to support the development of regional trading blocs.
5.0 OPTIONS FOR MONITORING COMMITMENTS

This section addresses the options for the way forward in monitoring commitments. In thinking about options for improving monitoring of commitments consideration should be given to three points.

First, past experience with donors and their capacity to honour commitments should be taken into account in order to minimize the chances of falling behind commitments this time round. It is important for both sides to take a realistic view of likely flows and make arrangements and plans to monitor commitments made. There is need to adopt an appropriate results-based approach, in which there is an agreement to monitor specific outcomes or targets that are attained. Donors are generally shifting towards a results-based approach, but this is limited by the difficulties in finding appropriate and monitorable outcome indicators and collecting relevant data on them in a timely manner. In practice, most PAFs seek to measure progress in both policies (i.e. inputs) and results.

Caution should be taken when monitoring commitments to make sure that there is no double counting with one form of aid substituting for another.

Second, all stakeholders consisting of domestic constituencies on the side of donors and country partners should be given space and impetus to participate more effectively in the monitoring processes. It may take time to raise awareness enough for the populations in the respective countries to put pressure on their governments to meet the agreed commitments but it is important that a concerted effort is made in this direction. Monitoring mechanisms to be proposed should include options for mobilizing the support of the key stakeholders including civil society and the private sector to contribute towards monitoring the implementation of commitments made.

Third, monitoring should be designed and implemented at the global level, regional and sub-regional level. Monitoring at all these levels should be designed to complement and reinforce each other.

Monitoring mechanisms should be set up consistent with a new framework of mutual accountability. Monitoring action should be organised at the country, at the regional and sub-regional levels and at the global level.

5.1 Monitoring Action at the Country Level

At the country level there is a real need for a set of country targets to be agreed upon between donors, governments and civil societies with the aim of improving the quality of aid and accelerating its disbursement. The matrix should be regularly monitored and effective sanctions imposed on parties who fail to meet their commitments. Civil societies and other pressure groups could be more involved in

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monitoring aid spending and encouraging public debate about aid performance and impact at country level. The monitoring mechanisms should give space for all stakeholders including the civil society and the private sector to make a contribution to the monitoring process. Monitoring systems that have been established in some countries such as Mozambique and Tanzania could be studied more closely to provide entry points for further action. In this context, Tanzania’s Independent Monitoring Group is worth examining with a view to promoting replication with the necessary adaptations. The Government of Tanzania and the development partners in the country have agreed to establish a mechanism for monitoring and evaluating progress in the aid relationships. The Independent Monitoring Group (IMG) and the terms of reference are endorsed by both sides and the reports produced by the IMG are subjected to joint discussion between the government and development partners with a view to reaching agreement on the next steps. A technical secretariat consisting of representatives from both sides has been established to carry out day to day monitoring of progress in implementing the recommendations of the IMG that have been agreed by both parties (government and development partners). Initiatives like the IMG concept in Tanzania could be replicated with adaptations as may be needed to reflect concrete country specific situations.

Partner countries should identify preferred aid modalities and establish indicators of progress towards those aid modalities and take actions which facilitate movement towards those aid modalities. Aid modalities which provide maximum flexibility in budget management should be preferred as budget management systems are improved. For instance, budget support has been growing in popularity as an aid modality for donors because it provides greater flexibility, and permits an easier allocation of resources in accordance with the national development priorities. In addition it is more amenable to policy dialogue and encourages the use and strengthening of national planning, budgeting and accountability processes. Quality of the whole public finance and expenditure management system, since donors need to be able to persuade their legislatures and authorizing bodies that the systems in place are as good as those they customarily use for aid, or that they at least meet a minimum standard, and that those systems are in the process of improvement and strengthening. While this is typically a donor concern, African countries are also giving governance concerns higher priority; and if economic governance is to be strengthened, the fragmentation of accountability systems among several donors and projects needs to be reduced. In this context, priority should be placed on developing the capacity to analyse various aid delivery mechanisms and modalities and proactively lead aid management and co-ordination processes.

Governments should be encouraged to establish clear aid management policies (e.g. Tanzania Joint Assistance Strategy, Uganda and others). The aid management policies and strategies would provide a guide to good practices in aid management and development cooperation that is consistent with the principles of the Paris Declaration. This is an area which has great potential for exchanging experiences among African countries at regional and sub-regional levels.

The governments should improve their aid statistics and have them disaggregated in a manner which would help to identify which donor flows are truly helping governments to scale up and giving them fiscal space to effectively implement their development strategies for achieving growth and poverty reduction targets which will have incorporated strategies for achieving MDGs.
In order to mitigate the problem of unpredictability African governments should prepare a 10 year development programme with its financial implications for achieving the MDGs clearly shown. These programmes should be the basis for discussing with donors and making them commit resources over a 10-year time horizon or as close to 10 years as would be permissible.

ODA resources are seen as complementary to domestic resources and foreign direct investment. The various sources of financing development should be analysed and projected over time with a view to ultimately exit from aid dependence. In this context, there is need to establish medium- and long-term development finance scenarios as a roadmap for setting framework conditions for aid, domestic resource mobilization and foreign direct investment and paving the way for rising domestic resource mobilisation and intermediation to ensure that short- and medium-term increases in aid dependence (which may be necessary at this stage for meeting MDGs) do not become permanent features in African economies.

5.2 Monitoring Action at the Regional and Sub-regional Levels

At the regional and sub-regional level, collective action is needed in the spirit of collective action to address the challenges and problems which are common to several countries in the region. This structure could be housed in existing regional and sub-regional institutions which are owned by developing country governments such as the regional economic communities, NEPAD/AU, UNECA and AfDB as may be deemed appropriate. The regional and sub-regional level organisations should take initiatives to step up collective action not only in managing the aid process but also in increasing the African voice in the WTO and other global negotiations.

Mechanisms that have already started working in the regional context should be strengthened. The role of APRM, an institutionalized source of peer pressure to improve governance is an encouraging development in putting the mandate of improving governance in the hands of Africans. The work of APRM needs to be extended to the area of economic governance and economic management.

The participation of Africa at regional level should be stepped up to participate more effectively in learning groups and exchanging experiences in the evolving aid relationships. Organisation of other stakeholders should be encouraged to support the monitoring process. Networks of civil Society organisations like the one that the Archbishop of Cape town has taken to launch the Africa Monitor should be supported to help hold into account African and donor governments and that way complement the government led-monitoring processes. This initiative should be replicated at national as well as at the global level.
5.3 Monitoring Action at the Global Level

At the global level there is a critical need for an independent international structure, which would enable developing countries to hold country partners and donors accountable. This should be based on internationally agreed time-specific targets, which are regularly monitored with civil society participation and publicly reported on.

It is proposed that high priority be accorded to strengthening the African Partnership Forum (APF) as the main forum for monitoring and reviewing progress including delivery of commitments made by all countries. APF meetings are frank and open discussions. The way forward now is to facilitate the APF to more effectively monitor donor and African commitments. The agreement reached in October 2005 to develop a Joint Action Plan containing key commitments on each side is very welcome and its operationalisation should deserve highest priority. With the Support Unit working with AU and NEPAD it should be possible to lay the groundwork for operationalisation of the agreed joint action plan which should be followed by annual progress reports to start coming out with effect from October 2006. The challenge here is to ensure involvement of high level political representation to provide the political will necessary to turn commitments into action.

The launching of the DAC Monitoring Survey should be followed by its operationalisation and should be widely supported by the members who endorsed the Paris declaration. The survey will establish an initial and comprehensive baseline against which progress can be monitored. So far 12 out 60 countries have confirmed their participation in the survey and it is hoped that more countries will be prompted to join in the surveys considering the importance of the survey results in encouraging a broad based dialogue at country level on how to make aid more effective and providing the necessary aid data for effective dialogue to be conducted at all levels.

The work that is being planned for SPA7 is expected to give space to African governments and their international partners to improve the quality and increase the quantity of aid, as well as improve the partnership relationships that are so essential to increasing aid effectiveness. The efforts that are being made in the new Strategic Partnership for Africa should continue to be strengthened to effectively complement the global monitoring mechanisms and Africa should organize itself to make effective use of this forum.

Networks of civil Society organisations at national, regional and global level should be encouraged to support the monitoring process. Initiatives like the one that the Archbishop of Cape town has taken to launch the Africa Monitor should be replicated at the global level.
The World Trade Organization (WTO) is where the rules of trade between nations are negotiated and agreed. The goal is to help producers of goods and services, exporters, and importers around the world conduct their business. In recent years, developing countries have become considerably more active in WTO negotiations, especially agriculture talks. Developing countries have successfully challenged some actions taken by developed countries in the WTO’s dispute settlement procedure. Without the WTO, these smaller countries would have been powerless to act against their more powerful trading partners. It is vital that Africa organizes itself, as it has already started doing under auspices of the African Union, to use the WTO ministerial meetings to make real progress towards a fairer trade system. Specific commitments such as ones to end cotton subsidies by the end of 2006 and to end all agricultural export subsidies by 2013 as agreed in the World Trade Organization’s Ministerial in 2005 should be monitored closely. The initiatives to monitor these commitments should be built into the WTO Ministerial meetings as a permanent agenda.

There is need to continue to gain agreement to debt cancellation at the Annual Meetings of the IMF and the Multilateral Development Banks.

There have been concerns over absorptive capacity. The initiative that will be made at the country level to make medium- and long-term development finance scenarios as a roadmap for setting framework conditions for aid should be supported by technical assistance from the IMF, possibly in the context of PRGF. The IMF should play the role of advising governments on the various scenarios and their implications on macroeconomic management. The DAC/World Bank initiative to survey donors' forward aid plans and the World Bank/UNDPs work to offer annual "Results and Resources Meetings" to developing countries will help to build clearer pictures at the country level of future aid flows. However, a large part of the solution to the limiting absorptive capacity lies in improving governance and investing in infrastructure and capacity development in the partner countries.

The initiative that the UN Secretary General has taken to appoint a High Level Panel to consider fundamental restructuring of UN agencies at the global and country level should be supported. In this regard, lessons can be drawn from countries where restructuring of the UN's work at the national level has been addressed. For instance, UN Agencies in Tanzania have undertaken a Joint Review of how their operations can better be aligned to national development priorities and processes and how the Agencies can reposition their activities for greater efficiency and effectiveness in the new setting of the second generation of PRS and changing aid relationships. Lessons from this experience could be useful to inform restructuring at global level as well at the national level in other countries.

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6.0 CONCLUSION

African governments have made commitments to implement national development strategies that incorporate MDGs based on domestic resource mobilization and support from the international development community. While the bulk of investments and government revenue come from domestic sources foreign sources play a key role in complementing the domestic resource mobilization efforts.

In this paper it has been argued that the role of aid in development raises serious concern in policy making. Aid has considerable economic, institutional and governance impact. The policy implication is that initiatives should be taken by recipients and donors to enhance aid effectiveness while an exit strategy is put in place to ensure a smooth transition from aid dependence. In the short run aid should continue to be used to fill important gaps in the economy with a view to achieving national development goals and MDGs. However, in the longer run foreign aid should go beyond the rather passive role of filling these gaps towards more actively engaging aid the process of closing these gaps. Higher levels of aid can reinforce local capacity enabling a country to achieve development goals and even to graduate from aid itself. The reduction of aid dependence is expected to enhance rather than disrupt socio-economic development in Africa and promote appropriate inclusion of Africa into the world economy. Taking into consideration the changing context aid globally the policy implications of managing the smooth transition from aid dependence have been put forward. These include redefining partnerships and promoting ownership, improving aid coordination, enhancing capacity building and capacity to manage change, reducing transaction costs by improving aid delivery mechanisms and donor policies and practices, improving budget management systems, enhancing the capacity to attain development goals, continuing to press for enhanced debt relief, stepping up efforts towards domestic resource mobilization, using aid to attract FDI, reversing capital flight and closing the foreign exchange gap through export development.

Commitments have been made to step up the volume of aid and to enhance its effectiveness in development. Building on the encouraging progress in the recent past, this paper has taken stock of financing development commitments made in 2005 and the progress that has been made in implementing these commitments. On the basis of that stock taking a reflection has been made on options for improving monitoring of these commitments with a view to making implementation of commitments more effective.

The relationship between Africa and its development partners is undergoing radical change. At the centre of this new relationship is the establishment by Africans of the African Union and NEPAD. The institutional capacity developments and strategic alliances among key African institutions have been growing at an encouraging pace recently. This should be a good basis for the way forward.
At the country level there is a real need for a set of country targets to be agreed upon between donors, governments and civil societies with the aim of improving the quality of aid and accelerating its disbursement. In this regard, lessons from other African countries can be usefully exchanged. Governments should be encouraged to establish clear aid management policies (e.g. Tanzania Joint Assistance Strategy, Uganda and others) consistent with the principles of the Paris Declaration.

In order to mitigate the problem of unpredictability African governments should prepare a 10 year development programme with its financial implications for achieving the MDGs clearly shown. These programmes should be the basis for discussing with donors and making them commit resources over a 10-year time horizon or as close to 10 years as would be permissible.

At the regional and sub-regional level, collective action is needed in the spirit of collective action to address the challenges and problems which are common to several countries in the region. The regional and sub-regional level organisations should take initiatives to step up collective action not only in managing the aid process but also in increasing the African voice in the WTO and other global negotiations. Mechanisms that have already started working in the regional context should be strengthened. The role of APRM, an institutionalized source of peer pressure to improve governance is an encouraging development in putting the mandate of improving governance in the hands of Africans.

At the global level there is a critical need for an independent international structure, which would enable developing countries to hold country partners and donors accountable. This should be based on internationally agreed time-specific targets, which are regularly monitored with civil society participation and publicly reported on. It is proposed that high priority be accorded to strengthening the African Partnership Forum (APF) as the main forum for monitoring and reviewing progress including delivery of commitments made by all countries. The challenge here is to ensure involvement of high level political representation to provide the political will necessary to turn commitments into action.
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