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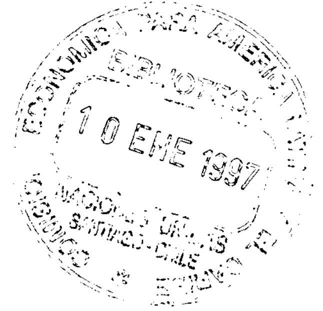
January 1997



Fourth Expert Group Meeting on Financial Issues of Agenda 21

Organized by the Department for Policy Coordination and Sustainable Development of the United Nations (DPCSD) together with the Economic Commission for Latin America and the Caribbean (ECLAC) and the Interamerican Development Bank (IDB) and co-sponsored by the Governments of The Netherlands and Chile

Santiago, Chile, 8 to 10 January 1997

WHAT FUTURE FOR AID? *

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(Draft - not to be quoted.)

97-1-10

Paper prepared for Fourth Expert Group Meeting; Santiago, 8-10 January 1997

WHAT FUTURE FOR AID?

Tony Killick[1]

EXECUTIVE SUMMARY

This paper argues that there is a crisis, not of declining aid volumes but of confidence in aid's developmental value. It suggests a strategy for resolving this based around greater selectivity of application.

Data on total aid flows suggest areas of concern rather than a crisis. Total oda is falling in real terms but only slowly and from the DAC it is still increasing a little. As of 1994, nearly twice as many DAC donors were still expanding their programmes as were cutting them. Some oda is being diverted from traditional applications but this is in response to genuine needs and the conflict with developmental objectives may not be large.

However, political support for oda has been diminished by a turning away from international co-operation in some major donor countries and by the reduced relevance of security considerations following the end of the Cold War. Past waste and frustrations have led to a less trusting, less tolerant view of recipient governments, the resulting desire to be more selective being powerfully reinforced by increasing budgetary stringency among donor governments.

This situation has been aggravated by a paucity of evidence showing oda to have clear developmental, poverty-reducing benefits. Its effects tend to be swamped, *inter alia*, by the effects of recipients' economic policies. Oda does contribute to faster economic progress when placed in an environment of sound policies but donors have not discriminated efficiently in favour of governments with good policy performance. Aid itself does not appear to bring much leverage over policy and over-reliance on conditionality has added to the waste. Evidence that aid has had a direct poverty-reducing impact is even weaker. Moreover, most of these negative judgements apply with particular force to African countries, where donors have concentrated their greatest efforts and where there are special concerns about the negative effects of aid dependency.

At the same time, the development model upon which the case for aid was originally based has been abandoned. A good many of the early criticisms of oda appear to have been born out by experience, not least the tendency for large-scale aid to distort incentives for private sector development. Aid appears less well suited for approaches to development which stress human development and the quality of life as objectives, and which see development as internally driven, propelled largely by private initiatives and market mechanisms.

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Furthermore, given the apparent ineffectiveness of much past TC, oda's potential to contribute to the crucial variables of human skill creation, institutional development, technological capabilities and the quality of policy interventions is also questionable.

For these reasons, faith in, and political support for, oda has much diminished. That is the true crisis. This, in conjunction with common sources of budgetary stringency in industrial countries, is liable to result in further, perhaps accelerating, declines in aid budgets, against which the UN's 0.7% target offers no defence. There appears to be little political support for finding new, international, sources of aid finance, independent of bilateral donor budgets. There remains a strong market failures case for maintaining aid flows to low-income countries but, given the past waste of much aid and doubts about its effectiveness, excessive concern about aid volume may be mistaken. Many of the weaknesses identified with aid occur when countries receive it on a large-scale. It matters more to improve the results obtained from the considerable volume of aid that remains.

A strategy is set out based on (a) reasserting an overriding developmental purpose for aid (broadly conceived); (b) changing to relationships with recipients based on ownership and acceptance of mutual obligations; (c) increasing the selectivity with which aid is allocated across developing countries, to concentrate on those which do not have adequate creditworthiness and which demonstrate a commitment to pro-development, pro-poor policies; and (d) tackling donor weaknesses which reduce the productivity of aid. The politics of the situation is the key, among both donors and recipients. If there is to be a fresh start, it is at the political level that it will have to be initiated.

I. IS THERE AN AID CRISIS?

It is often asserted nowadays that there is a crisis in the international provision of development assistance. This statement is often made with reference to global declines in the supply of oda so an examination of recent trends provides a natural starting point for this paper, as a preliminary to a discussion of the factors underlying these trends.

Trends in development assistance

First, Table 1 and Figure 1 set out trends in total net financial flows to developing countries, from which a number of features are immediately apparent:

* In current prices, total oda has been roughly constant, at slightly under $60 billion p.a., since the beginning of the 1990s.

* This constancy is, however, in marked contrast with strong nominal growth during the 1970s and 1980s.

* The growth trend of the 1980s was less dramatic when expressed in constant-price terms but was nonetheless still strong, whereas the constant-price series show a decline since 1992 (Figure 1). This change is too recent for it to be confidently described as a trend but there are, as we will see, reasons for believing that it may well be so.

* The recent decline is far more marked when oda is expressed relative to donors' GNP, with a fall from 0.34% to 0.27% in 1992-95 (Figure 1), i.e. by more than a fifth on only three years.

* Grants by NGOs, having also risen rapidly in the previous two decades, also levelled off in the 1990s (declining in real terms) and have remained at equivalent to less than a tenth of official oda (Table 1). Charitable giving, in other words, is not compensating for the stagnation in official aid.

* There have, nonetheless, been large increases in total net financial flows to developing countries due to a remarkable rise in the volume of various types of private capital flows, so that the share of private capital in total flows went up from 41% in 1990 to 60% four years later (Table 1).

There are a few other salient facts, not included in the table and diagram, which should be added:

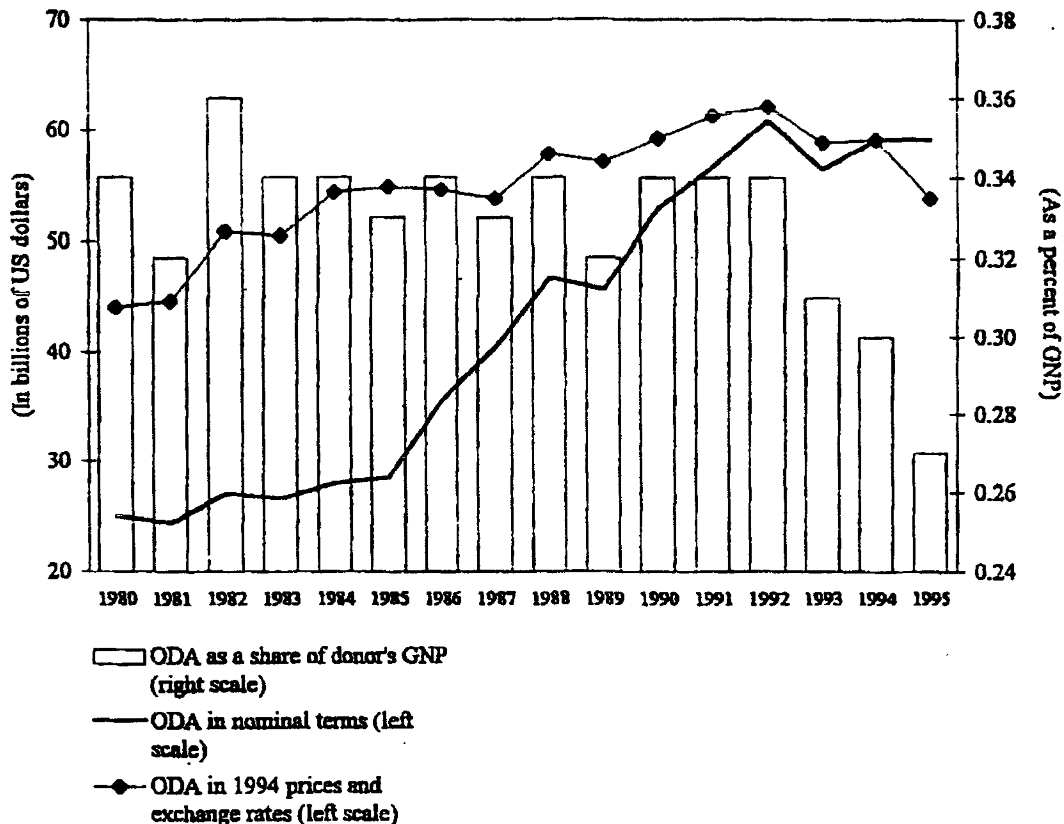
* Official aid[2] from non-OECD countries has dwindled to insignificant levels in recent years. The substantial aid programmes of the former COMECON countries of Eastern Europe and the Soviet Union are a thing of the past. Aid from OPEC countries is also far below its peak of the early-1980s. Some former recipient countries have become

[2] 'Aid' and 'oda' are used synonymously in this paper.

net providers (e.g. Korea and Turkey) but only on a small scale. Flows from all non-OECD countries made up only 2% of estimated total oda in 1994 and their decline as providers of aid has helped to depress the global totals. OECD countries are now the only significant providers of aid. Of these, eight countries (Canada, France, Germany, Italy, Japan, Netherlands, United Kingdom and United States) contribute over four-fifths of the total.[3]

Figure 1

Net ODA Disbursements, 1980-1995



Source: IMF, 1996, Chart 2. Derived largely from DAC sources.

[3] Based on DAC statistics for 1994, net disbursements by these countries to developing countries and multilateral organisations amounted to $49.1 billion, or 83% of the DAC total for that year. Of course, total flows do not provide a good indicator of aid performance because it takes no account of donor country size or economic circumstances. Expressed as the grant equivalent relative to GNP, the oda programmes of several of these eight countries is below-average: Italy, Japan and (especially) the United States. By this criterion, the top performers are Norway, Sweden, Netherlands, France and Canada, in that order. Source: DAC, 1996, Tables 4 and 7.

Table 1. Net Flows of Financial Resources to Developing Countries, 1970-94
($billion in current prices and exchange rates)

	1970	1975	1980	1985	1990	1991	1992	1993	1994
Official development finance	**8.9**	**18.3**	**34.3**	**44.1**	**69.7**	**69.6**	**70.5**	**69.5**	**70.2**
oda	7.9	14.9	27.3	32.9	52.8	58.5	59.5	56.2	59.7
other odf	1.0	3.4	7.0	11.2	16.9	11.1	11.0	13.3	10.5
Export credits	**2.7**	**5.6**	**16.1**	**4.0**	**4.7**	**1.8**	**1.3**	**-0.9**	**3.2**
Private flows	**8.3**	**22.8**	**65.5**	**30.1**	**51.8**	**50.8**	**76.8**	**94.1**	**110.4**
direct investment	3.7	11.4	11.2	6.5	26.4	22.6	27.3	38.8	47.0
bank lending	3.0	8.5	49.0	15.2	15.0	11.0	31.0	9.0	21.0
bond issues	0.3	0.4	1.1	4.2	0.9	6.5	11.1	36.6	32.7
other private	0.4	1.2	1.8	1.3	4.4	5.3	1.4	4.0	4.0
grants by NGOs	0.9	1.3	2.4	2.9	5.1	5.4	6.0	5.7	5.7
TOTAL FLOWS	**19.9**	**46.7**	**115.9**	**78.2**	**126.2**	**122.2**	**148.6**	**162.7**	**183.8**
oda as % of total	40	32	24	42	42	48	40	35	32
private as % of total	42	49	57	38	41	42	52	58	60

Source: Annual DAC reports on *Development Co-operation*, various issues.

* Although very large in relation to total flows to developing countries, private capital flows are heavily concentrated in a small number of (generally more industrialised) developing countries. Notable recipients of direct investment include Argentina, Malaysia, Singapore, Indonesia, Thailand and - the largest single recipient - China. Bond finance is similarly concentrated on a modest number of Asian and Latin American countries. Griffin and McKinley (1996, p.63) show for 1993 that only 8% of the total net flow of long-term private capital to developing countries went to countries classified as low-income. Sub-Saharan Africa remains almost wholly reliant on oda and other official inflows.

* Griffin and McKinley (*ibid*) go further and net out interest payments, profit remittances and other (non-labour) return flows attributable to private capital. The resulting net resource transfers are shown to be well under half (43%) of the unadjusted figures (although some would question the legitimacy of such adjustments). For low-income countries, the resulting net figure for 1993 (latest available) is a mere $1.6 billion, against nearly $22 billion of oda.

* Donor-by-donor data do not indicate a widespread trend towards declining aid budgets. Of 21 DAC donor countries, seven recorded a declining trend (in real terms) in 1988/89 to 1993/94, including, among those with the largest aid programmes, Canada, Italy, Netherlands and the USA (DAC, 1996, Table 6a). For the most recent 12-month period, eight of the 21 showed declines. For both periods there was a modest overall increase in the real volume of oda from DAC countries.

Beneath these global trends, significant changes have been occurring in the use of aid resources which also bear upon the availability of aid for development. First, DAC statistics show that aid to the 'transition economies' of Eastern Europe and the former Soviet Union, and to other European countries, increased from $0.36 billion in 1989 to $8.93 in 1994, absorbing 13% of total aid in the latter year and helping to explain the stagnation of aid to developing countries proper.

There has also been an increased use of aid for debt relief. It has for some years been Paris Club policy to encourage donor governments to forgive past aid loans, i.e. to convert them into grants. For the most part, the cost of doing so has been treated by donors as a claim on their aid budgets and DAC figures indicate that in recent years loan write-offs have absorbed around 5% of total oda.

However, such a provisions are only a modest proportion of the aid resources devoted to debt relief. In addition, donor countries have been required to subsidise ESAF and IDA lending by the IMF and World Bank for the purposes of refinancing these institutions' past loans and to avoid borrowing countries going into default. Such claims will increase under the recently-agreed initiative for dealing with the multilateral indebtedness of low-income countries ('the HIPC initiative'). In addition, various donor governments have participated in 'Support Groups' for countries which have slipped into arrears with multilateral lenders, providing transitional finance until the debtor countries can restore their eligibility for new multilateral credits. An even larger number of donors has participated in attempts to garner additional bilateral support for debt-related adjustment programmes, e.g. through the Special Programme of Assistance for sub-Saharan Africa (the SPA). Although unknown, the total amount of aid devoted to these debt-related efforts is undoubtedly large.

Whether this should be regarded as a diversion from developmental applications is a moot point. Since the overhang of debt can be regarded as an obstacle to new investment and debt relief is conditional on Fund-Bank structural adjustment programmes, the use of oda for debt relief can be regarded as developmental, just another form of programme aid. Against this, the strength of the 'overhang' argument for low-income countries is open to dispute and the effect of using aid for debt relief is undoubtedly to divert it from investment in specific projects, and the provision of social and economic services. Allocating aid according to the severity of countries' debt problems is not at all the same as doing so by developmental or poverty criteria.

Thirdly, we should note a trend towards the use of aid for emergency relief. The sums devoted to emergency aid tripled in real terms in 1990-94, with a similar proportionate rise in the share of total aid absorbed in this way, to about 6% in 1994. However, as Riddell (1996, p.33) points out, there is no sharp distinction between emergency and development relief, particularly in the most vulnerable countries.

Although it is impossible to be at all precise, there seems no doubt that the three trends just described represent a substantial diversion away from more traditional developmental applications. If we assume, arbitrarily, that half of the aid going to the transition economies would otherwise have been available for developing countries, perhaps $15 billion, equal to a quarter of 1994 oda to developing countries, could have been provided for development in the absence of these competing uses, most of which have only become significant in the 1990s.

Finally, we should note that the share of total oda to developing countries claimed by sub-Saharan Africa has risen steadily, from 19% in 1975 to 31% in 1994. Southern and Central Asian countries have been the chief losers, their share declining steadily from 21% to 7% over the same period. The extent of African countries' present-day reliance on aid is startling. Table 2 shows both the large size of aid inflows relative to domestic saving, investment and imports, and the severe worsening of these ratios since 1980. The contrast between Africa and the other developing regions is stark, with Southern Asia showing declining reliance on aid, and the other regions only small use of aid.

This concentration on sub-Saharan Africa, while it does address the region with the greatest development problems and the most rapidly deteriorating occurrence of poverty, is also a source of difficulty, for two reasons. First, the high present-day level of African dependency raises the fear that, because of its large relative size, aid may have become part of the problem. We shall see later that there are reasons for fearing this might be so. Second, Africa's limited geo-political and trading importance weakens donor self-interest in the maintenance of large aid programmes, and this may have contributed to the poor recent showing of a number of aid budgets.

Bearing all the above factors in mind, can we say that aid is in crisis? The figures suggest areas of concern rather than a crisis. Total oda is falling in real terms but only slowly and from the DAC it is still increasing - but only just. As of 1994, nearly twice as many DAC donors were still expanding their programmes as were cutting them. There is some tendency for aid to be diverted from traditional developmental applications but this diversion has been in response to genuine needs and any conflict with developmental objectives may not be large.

But the idea of a crisis should not be dismissed too lightly. For underlying the statistical trends just discussed have been important changes in the global environment conditioning rich countries' motivations for maintaining aid programmes, as well as a loss of confidence in the benefits of aid and its role in development. We therefore turn to examine these underlying influences.

Changes in the global context

By universal agreement, the end of the Cold War greatly affected the environment, for many donors had used their aid programmes, *inter alia*, in pursuit of foreign policy and security objectives. Various recipients lost much of their geo-political importance and suddenly found their formerly reliable aid supplies drying up. In Africa alone, the cases of Ethiopia, Kenya, Mozambique, Somalia and Zaire immediately suggest themselves. The ending of the East-West ideological divide has tended to reduce donor government interest in their aid programmes. Not only that, but former COMECON countries that had previously been donors themselves became claimants on aid resources, as we have shown.

Table 2. Indicators of Aid Dependency, selected regions and years

indicator	year	sub-Saharan Africa	South Asia	Mid-East and N.Africa	Latin America & Caribbean	All developing countries[a]
ODA as % GNP	1980 1994	3.4 12.4	2.4 1.4	1.1 1.6	0.3 0.3	1.1 1.1
ODA per capita	1994	57	4	25	10	12
ODA as % GDS	1980 1994	12.6 77.5	16.0 7.0	... ...	1.3 1.5	3.9 4.2
ODA as % GDI	1980 1994	14.8 72.9	12.0 6.4	... ...	1.2 1.4	4.2 4.1
ODA as % imports	1994	51.5	11.5	6.3	2.2	5.2
memo item av. GNP per capita	1994	460	320	1580	3340	1090

Note: [a] All low- and middle-income countries.
Source: Calculated from World Bank, *World Development Report, 1996*, Development Inidcator tables.

The ending of the Cold War coincided with a gradual erosion of support for international cooperation in the USA. Seeing itself as having 'won' the Cold War against a now-defunct USSR, a Republican-dominated Congress has shown little interest in the maintenance of a major programme of development assistance (as distinct from transfers to some favoured Middle Eastern countries). Aid budgets have been cut and formal obligations, e.g. for payments to IDA, have not been honoured (with the consequence that at present the persistence of US arrears to IDA is endangering the future of that facility, because of the importance attached by other contributors to the burden-sharing principle).

A more subtle and gradual change has occurred in donor-country attitudes towards developing countries, particularly among former metropolitan powers towards former colonies. There was undoubtedly an important element of guilt in the relationships created in the first decades of large-scale aid. More generally, there was implicit belief both in the potency of aid to accelerate development by filling financing gaps and in the ability of recipient governments to put the finance to good developmental use.

Over time, these attitudes have changed. Guilt has faded and the plausibility of explanations of continuing underdevelopment in terms of past colonial exploitation has dimmed.[4] Frustration with the apparently limited efficacy of much past aid and increased awareness of corruption, economic mismanagement and abuse of human rights has made donor governments (and their electorates) less trusting, less tolerant, more inclined to resort to conditionality, a little more choosy about the governments they support. Increased awareness of large-scale capital flight from poor countries, and evidence that this is correlated with inflows of capital from the rest of the world, has added further to donor-country scepticism.

This change in attitudes is nicely illustrated by the evolution of relationships between the European Union and the 'ACP' group of developing countries, as embodied in successive Lomé Treaties. By its original ideals, the relationship (which went beyond aid to the provision of trade privileges) was to be based on Treaty obligations by co-equal partners (although inevitably the reality never matched up to this). In the aid area, unconditional medium-term country allocations were agreed. Such rights have gradually been eroded, however. The European Commission increasingly has recourse to policy conditionality, or provides programme aid in support of Fund-Bank adjustment programmes, as well as concerning itself with the extent of democracy and rule of law within recipient countries. The future renewal of a Lomé-style relationship is now in question and the Commission looks increasingly like other donor agencies in its somewhat more wary and selective approach to the allocation of aid.

The increasing globalisation of product and financial markets has also had an impact on the aid environment. As we will see shortly, it is becoming more difficult to explain why large-scale public development aid (as distinct from emergency relief or humanitarian assistance) is needed in the face of burgeoning and increasingly efficient international capital markets. Finally, for reasons that will also be discussed later, the total budgets of virtually all donor governments are coming under increasing strain. It has become more difficult for these

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[4] But see Killick, 1994, among others, for an account of the continuing retarding influence of conditions at the time of independence on the development of African economies.

governments to reconcile their electorates' resistance to taxation with their demands for public services and transfers. And with public services under stress, it is politically harder to protect aid budgets.

Evidence on the effectiveness of aid

The difficulties created by the global developments just described have been compounded by the results of a succession of academic attempts to measure the impact of aid inflows on recipients' economic growth, which mostly fail to find a significant positive association.[5] Mosley's (1987, chapt. 5) conclusion is fairly representative of this literature: 'there appears to be no statistically significant correlation in any post-war period, either positive or negative, between inflows of development aid and the growth rate of GNP in developing countries when other causal influences on growth are taken into account' (p.139). He is, however, careful to point out that there may be good reasons for this and that care has to be taken in deriving any judgements from it about aid effectiveness. The multitude of other factors bearing upon growth, and the complex interactions between them, make it difficult to isolate the impact of any one input into the system. An even more fundamental difficulty is that countries experiencing severe economic problems, resulting in sub-standard growth, are regarded by donors as therefore requiring more assistance - precisely what has happened in Africa. Donors, in other words, are not in the business of picking winners, nor do they design aid interventions simply in order to maximise growth. Nonetheless, the scarcity of evidence that aid has growth- (or investment-) enhancing effects is nonetheless a source of disquiet.

Academic investigators have gone further, to try to isolate the main determinants, at the macroeconomic level, of the growth and investment effectiveness of aid. ODI's (1993, p.27) survey concluded that the main correlates were (i) the rate of return on public and private capital; (ii) the allocation of aid between the recipient government's development and recurrent budgets, i.e. the fungibility of aid; and (iii) the impact of aid on the structure of prices facing the private sector, particularly private investment. Other investigators, too, have found the fungibility factor to be an important determinant. There is (now seriously out-of-date) evidence of a tendency for aid to be used to reduce taxation (Heller, 1975); far stronger, more recent, evidence that much aid leaks into public sector consumption[6] A recent World Bank study (Feyzioglu *et al*, 1996) found that of every $1 of net oda, roughly three-quarters went to increase governments' current expenditures and only a quarter to capital spending.

Several studies have focused on the *quality of domestic economic policies* as a determinant of the ability of aid to make a difference to growth and investment. The connections between

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[5] These studies are usefully surveyed in an (unfortunately unpublished) ODI survey of the aid effectiveness literature (ODI, 1993), on which I shall draw quite heavily below. See also the recent contribution by Boone, 1994, Burnside and Dollar, 1996, and on-going work by Mosley and associates.

[6] We should remember, however, that some of what is counted as 'consumption' could more appropriately be regarded as investment, or at least developmental, spending, most notably the on-going costs of public educational and preventative health services.

this and the factors mentioned in the previous paragraph are clear. The allocation of revenues as between recurrent and capital expenditures is largely a matter of policy priorities. Similarly, there is much evidence of the impact of the policy environment on the rates of return to public and private investment. Burnside and Dollar (1996) confirm others' findings that, taking all countries together, aid receipts have little impact on economic growth. However, they take the analysis further by developing (largely macroeconomic) indicators of the quality of country policies and investigating the influence of this factor, obtaining "a robust finding that aid has a positive impact on growth in a good policy environment" (p.33).

This is in line with other studies showing the importance of the policy environment as an explanator of contrasting country economic performances.[7] Their result is consistent with the overall absence of an aid-growth correlation because of the limited extent to which donors discriminate among recipients on the basis of the quality of policies: they found that, on balance, 'good' policies were rewarded by more aid but that "other variables, which we regard as reflecting donor interests, have even greater explanatory power" (*ibid*).

Moreover, they found that aid does not appear to induce improvements in policy. This finding is strongly confirmed by the present writer's own on-going work on donor conditionality, which finds much evidence of donor reluctance, or inability, to punish poor policy performance by withholding aid (Killick, forthcoming, chapter 6). Absence of effective enforcement of conditionality helps explain the weakness of evidence on the effectiveness of that large segment of aid devoted to the support of structural adjustment programmes.

Assessment of the effects of these is fraught with controversy but enough evidence has accumulated to show that programmes have had limited ability to achieve their own objectives.[8] While both IMF and World Bank programmes have been associated with improvements in export performance and other balance of payments indicators, they are not systematically correlated with increased economic growth. One reason for this is that they are associated with reduced investment levels. Programmes seek to achieve improved economic performance by raising the quality of domestic policies and strengthening institutions but the evidence suggests, in common with Burnside and Dollar's findings, that programmes have only modest impact on key policy variables, even less on institutions. Even such limited claims as can be made probably over-state the degree of programme influence because some of the policy changes would have been introduced in any case. Moreover, a good many of the reforms are not sustained, with some governments regressing, reverting to old practices or introducing equivalent interventions through the back door.

Leaving donor foreign policy, security and commercial interests to one side, the basic justification for aid transfers from high- to low-income countries is that it *reduces poverty*. Here too, however, the evidence is not encouraging. Looking at the broad trends in the distribution of oda described earlier, while the rise in the share of sub-Saharan Africa can be regarded as a positive response to the large and growing poverty of that region, we should

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[7] See Killick, 1991 pp.20-26, for a survey of some of this literature.

[8] I am here paraphrasing the results of a detailed survey of the evidence on the effects of adjustment programmes in Killick (forthcoming, chapter 2).

also remember that most of this reallocation has been at the expense of Southern and Central Asian countries, a high proportion of whom are also beset with much absolute poverty. At a less aggregated level, a wealth of studies show that country allocations of aid are poorly correlated with the average income levels of the recipient countries, although some donors have been better at this than others.[9]

However, even though it is a cliché of the aid industry, it is necessary to remind ourselves here that aid transfers to *governments of poor countries* does not necessarily mean that much of it benefits *poor people*. Although this does not appear to be an aspect which has been studied much, casual observation suggests that donors have not systematically favoured governments with effective poverty-reducing policies. Not the least of the problems of aid to Africa is that only a minority of the governments of that continent can demonstrate that they give priority to poverty reduction and have initiated substantial anti-poverty programmes. From this point of view, the net poverty effect of the reallocation from Southern Asia to Africa is ambiguous at best, probably regressive.

How effective have donors been in getting their aid directly to those living in absolute poverty? Mosley (1987, p.181) concludes his examination by suggesting that while donors continue to say that they wish to help the poor 'that desire does not penetrate very far into administrative procedures, so that such help as the poor and destitute get from aid is largely adventitious . . .' While not going as far as this, Riddell (1987, p.226) also stresses the difficulties that donors have encountered in reaching the poor. Perhaps alone among independent observers, Cassen (1994, 54-55) reaches a more positive conclusion, stressing the importance to the poor of aided projects which raise agricultural productivity and improve social services. However, he also stresses the way that donors' non-developmental objectives constrain the targeting of aid for poverty-reduction, as well as the limitations on what can be done in the face of recipient-government indifference. One of the points of difficulty is that most of the poor live in rural areas. While the World Bank (1990, p.130) has drawn attention to a range of rural projects which have aided the poor, virtually all evaluations are agreed that agricultural and other rural projects have among the lowest success rates.[10]

Further insight is obtained from the preliminary results of on-going ODI research into the use of aid for poverty reduction by the countries of the European Union. These appear to validate for today Mosley's 1987 assessment, just quoted. It appears that most European donor agencies do not have an overriding poverty-reduction objective. Some still argue that their aid, by promoting economic growth, reduces poverty indirectly but without articulating any clear connection between their aid interventions and the welfare of those living in poverty. The error of conflating aid to the governments of poor countries with aid to poor people remains remarkably common. Only exceptionally are specific poverty groups identified. The collection of data to permit evaluation of the poverty effects of specific projects is even rarer. There appears to be a large gap between present practices and what would be possible on a best-practice basis, confirming that this major group of donors (with honourable exceptions) has yet to give direct poverty-reduction high priority.

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[10] Four-fifths of all World Bank (1989a) projects surveyed in the OED's 15-year overview which yielded negative *ex post* economic rates of return were agricultural.

[9] See ODI, 1993, pp.5-7, for a survey of this evidence.

Finally in this catalogue of woe, we should add that in concentrating increasing proportions of their oda on sub-Saharan Africa donors have selected the region which, by common consent, presents the greatest difficulties. As much is suggested by comparing Africa's very high levels of aid dependency, illustrated in Table 2, with the poor economic performance of that continent, both absolutely and by comparison with other developing regions. Less impressionistically, studies indicate lower rates of return - and higher failure rates - from aid projects in Africa, particularly weak relationships between aid inflows and economic growth, and especially large difficulties with adjustment programmes.[11]

The above admittedly presents an unbalanced picture. For one thing, it ignores the more positive outcome of assessments of aided *projects*, which generally find well over half of these to have produced satisfactory outcomes (although these assessments have often been criticised for exhibiting 'evaluation optimism'). It also ignores the multiplicity of donor objectives in supplying aid. The main point, however, is that it is difficult for advocates and practitioners to point to convincing evidence that oda produces clear developmental benefits. This puts them on the defensive and undermines faith in the value of the activity, making it all the harder to defend aid budgets in an atmosphere of general budgetary stringency.

Models of aid and development

The condition just described is worsened by growing doubts about how aid fits into a present-day understanding of the dynamics of economic development.

In the early years of explicit concern with the problems of 'underdeveloped countries', when development economics emerged as an important sub-branch of the wider discipline, the notion of financial transfers from rich to poor nations fitted comfortably within the predominant model of development of that period. This tended to conflate development with growth and largely saw the latter in terms of the investment rate. Thus, with the incremental capital-output ratio (approximately, the inverse of the marginal productivity of capital) taken as a given, the well-known Harrod-Domar model showed that the rate of growth was determined by the ratio of investment to GDP. It was therefore possible to state the investment rate necessary to produce a given target growth rate (always assuming a constant ICOR).

Given further assumptions (or information) about domestic savings capabilities, it was then simple to estimate required levels of capital inflows from the rest of the world and, by subtracting likely inflows of private and other sources of capital, to derive residually estimates of needed aid inflows. Since 'underdeveloped countries' were by definition poor and saving propensities were regarded as rising with income, it was reasonable to postulate that domestic saving was likely to fall well below the level required to sustain investment at levels that would generate a satisfactory pace of economic progress. And since private capital inflows were at that time generally modest (and there was, in any case, much debate about the benefits of foreign direct investment), oda needs were shown to be large, both in aggregate and in a high proportion of individual underdeveloped countries.

[11] See Killick, 1991, pp.14-17, for documentation of the statements made here.

This rather simple approach subsequently gave way to a rather more sophisticated 'two-gap' model. This added to the saving-investment gap of the Harrod-Domar model the idea of a second gap, between the supply and demand for foreign exchange, which might be even more difficult to fill. Two-gap analysis introduced the important idea of structural rigidities preventing the ready conversion of domestic saving into an equivalent release of foreign exchange. In relatively inflexible underdeveloped economies, it was argued, resources and demand could not readily be switched between tradeables and nontradeables, a condition which may be worsened by protectionism in industrial countries and by shortages of imported inputs. In such situations, forex gaps may exceed saving-investment gaps, in which case the former would be the dominant constraint on growth and would define the volume of oda needed to achieve a given growth rate.[12]

From either of the approaches sketched above it was possible to derive estimates of requirements for total capital flows from developed to underdeveloped countries and, as a component of this, estimates of aid needs. It is not clear whether the still extant 0.7% aid target was an outcome of such calculations but it clearly *could* have been. The history appears to have been that in 1960 the UN General Assembly adopted a target of 1% of the national incomes of developed countries for the total flow of all forms of financial resources, although the basis for this figure is now unclear. In 1969 the Pearson Commission recommended an oda target of 0.7% of GNP. This was adopted by the General Assembly in the following year and remains formally in place today.

In the meantime, however, almost all the thinking which underlies such estimates of need has been discredited. We no longer equate development with growth (although that dies as hard as most bad habits). We no longer think that the marginal productivity of capital is unaffected by the volume of investment, for many countries have managed periods of high investment without achieving satisfactory growth (because the resources were poorly invested). Indeed, we no longer think that physical capital formation, *per se,* is the prime mover of economic development. Moreover, experience has shown that quite poor countries can sustain high savings rates if the right policies and incentives are in place. The relevance of two-gappery has been reduced by the movement towards more flexible exchange rates and by the diversification of many (non-African) developing countries away from reliance on primary product exports.

These changes of view, together with the rise in private capital flows to developing countries, inevitably raise questions about the place of oda in development. The arguments of writers of the political Right, who have long been critical of aid, appear in a number of respects to have been validated by experience, which has further undermined intellectual support for oda.[13] These critics see development as essentially driven by domestic forces, often of a

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[12] More recently, three-gap models have been introduced, with the government's revenue-expenditure balance identified as another potentially binding constraint. This was developed particularly in the context of the debt crisis of the 1980s, when the servicing of large external debts necessitated the generation not merely of large saving-investment and balance of payment surpluses but large budgetary surpluses too.

[13] See Bauer, 1971, for a trenchant statement of the following line of criticism and Lal, 1996, for a recent restatement of the Rightist critique. Riddell, 1987, provides a balanced assessment of the arguments of this school.

deep-seated cultural-historical nature. Aid is therefore not indispensable for development and may get in the way by distorting incentives. Particularly pernicious, in their view, is the tendency for oda - being channelled almost exclusively to governments - to reinforce a bias towards extensive state interventionism, to the disadvantage of private enterprise.

Looking back from the vantage-point of 1996, Lal see large-scale official oda as an historically unique response to the breakdown of international capital markets in the inter-war period, reinforced by a welfare-based humanitarian ethic in favour of transfers to reduce poverty. Appreciation that aiding the governments of poor countries is not the same as aiding poor people, plus oda's limited success in actually reducing poverty, has sapped the humanitarian motive, just as the growth in size and efficiency of private capital markets has undermined the efficiency case. While Lal acknowledges that private capital still shuns some low-income countries, chiefly in Africa, he attributes this not to their poverty but to the 'predatory' nature of their governments. Unless this is addressed, not only will private capital stay away but aid is unlikely to bring developmental benefits either. "The foreign aid programmes of the last half-century are a historical anomaly ... an idea whose time has gone!" (pp.12-13).

Much of thinking upon which the Rightist critique is based now finds acceptance across a wider spectrum of opinion. As much has already been indicated earlier in this paper. In particular, the lessons of experience - in developed and developing countries alike - have forced a re-evaluation of the role of the state in development and this foment has inevitably raised questions about the value of oda in its traditional forms. The emphasis now is on raising the *quality* of state interventions[14] but, while it is not difficult to see how aid might obstruct institutional reform and development, it is less clear that external donor agencies can do much to promote the needed institutional changes.

The danger that large-scale aid inflows may distort incentive signals finds a similarly wide acceptance today. There are both specific and general aspects of this. Food aid, for example, was long criticised along these lines (although most food aid donors are nowadays more careful to avoid weakening local farmers' production incentives than they used to be).

Another specific distortion relates to the possible 'Dutch Disease' effects of oda receipts. The danger here is that, by providing a major additional supply of foreign exchange, aid interferes with exchange rates, such that the local-currency price of foreign exchange is lower than would otherwise be the case, causing the local currency to be over-valued and discouraging exports. A different line of explanation that leads to the same policy outcome points out that, since aid finances imports this leads to an under-pricing of imported goods (including capital goods) relative to exports and non-tradeables (including local labour). The under-pricing of tradeables *vis a vis* nontradeables is, of course, synonymous with currency over-valuation.

Moreover, this is not merely a theoretical possibility. van Wijnbergen (1986) explored this and found empirical evidence that aid has a Dutch Disease effect. Younger (1992) investigated this for Ghana and also found evidence of a currency-appreciating effect. At a

[14] The World Bank's forthcoming 1997 *World Development Report* is planned as an extended essay on that theme.

more casual level, the length of time the Franc Zone countries of West and Central Africa were able to cling on to an increasingly inappropriate exchange rate until the pressures for devaluation of the CFA franc eventually became irresistible in 1994 was surely only possible because of the large volume of support they received from France and elsewhere. Similarly, logic suggests that, in the absence of policy correctives, aid at the levels for Africa reported in Table 2 *must* have an upward effect on exchange rates, where these reflect supply and demand. The implication, of course, is that large-scale oda tends to discourage exports - a serious charge in relation to the small, trade-dependent economies of Africa and elsewhere.

Official oda also affects the incentive system facing governments in their conduct of fiscal policy. As noted earlier, it may weaken the tax effort, with aid substituting for local revenues. This is a type of moral hazard problem, a member of a larger class of situations in which the 'soft budget constraint' offered by relatively stable and large inflows of assistance may dissuade governments from unpopular but economically desirable actions (e.g. reducing the size of inflated public services) they may otherwise be unable to avoid. My own research on the effects of programme aid has yielded many examples of this (Killick, forthcoming, chapt. 6).

Quite apart from moral hazard, oda which is large relative to total government revenues may distort the composition of government spending in favour of the type of activity, or project, which can most easily attract aid. This may have a number of undesirable characteristics: skewing spending in favour of large new projects with high import contents, and giving rise to under-budgeting for the maintenance and utilisation of past capital projects, as with roads whose maintenance is neglected until their condition is bad enough that they can be justified as (aid-funded) rehabilitation projects. At its worst, this type of bias may so undermine the utilisation of past aided projects that the process threatens to become nugatory.

Furthermore, donor practices have sometimes undermined budgetary control and discipline in recipient countries, often because of agency desires to spend their budgets. Sometimes donors have pursued the tactics of the Pied Piper, deliberately selecting for assistance activities in sectors they believe to be neglected, in the expectation that this will force a government to spend more because of the recurrent costs of the aid projects (Howell, 1985, p.13). More generally, past neglect of the recurrent cost implications of aid projects has added to the difficulties of budgetary planning. Even more seriously, donors sometimes evade normal budget procedures altogether, setting up quasi-autonomous project administrations, or augmenting the salaries of local civil servants, or paying suppliers direct, all undermining the fiscal authority of the Treasury. Take Adams' description of the 1980s situation in the Sudan (1989, pp.187-88):

> Sudan's total dependence on foreign assistance constrains its ability to control the free-wheeling activities of donors. The hold of the Ministry of Finance and Economic Planning over the donor agencies is tenuous. Even some of the long-established bilateral donors ... are disbursing outside the government budget, in some instances without any formal agreement with the central authorities. For most intents and purposes, the government system of annual budgeting of development and recurrent expenditure has collapsed. In the circumstances, bilateral agencies tend to become a law unto themselves, preferring to retain their freedom to disburse funds in the most opportune

> manner and to provide the authorities with just sufficient information to justify their continued presence. Projects are often funded through informal, ad hoc channels. For example, to ensure the loyalty and commitment of government staff attached to projects, donors find it necessary to make incentive payments and to pay retainers to senior government personnel to act as 'consultants'.

There is also the danger, identified in the earlier description of the Rightist critique of aid, that, being channelled to governments, it hampers private sector development. Quite apart from allegedly buttressing a *dirigiste* approach to economic management, aid may discourage private investment (in the tradeable goods sector, at least) through its Dutch Disease effects, just discussed. It may do this directly or, as found by Younger (1992, p.1595)) for Ghana, as an unintended by-product of policies designed to counter the macroeconomic effects of large aid receipts:

> ... the aid flowing towards Ghana has worked at crosspurposes with some of the reforms in recent years by driving up aggregate demand and by making foreign exchange relatively abundant. The Ghanaian authorities' attempts to counter the increased aggregate demand by tight monetary policy have made credit extremely scarce, thus crowding out private investment.

Yet another channel through which oda might act as a disincentive for private investment is through the so-called 'debt overhang' effect. It is well known that among many aid-reliant low-income developing countries indebtedness to the IMF, World Bank and other multilateral agencies has been growing rapidly, to which the recent 'HIPC initiative' is a response. The argument here is that the overhang of this debt, and the increasing claims that the servicing of this makes upon debtor-country resources, acts as a kind of tax on increments to private sector output and increases uncertainties about future profitability.

Against these potential disincentive effects, there is the countervailing influence, for the existence of which there is a large volume of accumulated evidence, that certain public sector investments stimulate private investments by raising the expected rate of return (or lowering the perceived risks) of private projects, e.g. when public sector investments in transport and communications reduce private sector production or distribution costs (the so-called 'crowding-in' effect).

In the face of these contrary impulses, the net effect of oda on private investment is an under-researched issue but a recent study of 36 developing countries in 1977-91 by Snyder (1996) finds a negative association between them, particularly in low-income countries: "The results clearly show that countries which receive larger aid allocations experience lower subsequent levels of private investment" (p.735) (note the word "subsequent", implying that causality runs from aid to reduced private investment).

There is a further aspect of the Rightist critique which now receives wider acceptance, namely, a view of national economic development as essentially driven by domestic forces. This has entered the conventional wisdom on aid via the concept of 'ownership'. In the context of policy reform I have described this in the following terms (Killick, forthcoming, chapter 4):

> Government ownership is at its strongest when the political leadership and its advisers, with broad support among agencies of state and civil society, decide of their own volition that policy changes are desirable, choose what these changes should be and when they should be introduced, and where these changes become built into parameters of policy and administration which are generally accepted as desirable.

The opposite case is given when reforms are donor-initiated and designed, with little domestic support and few local roots. In such cases we can say the measures are donor-owned. The danger, of course, is that aid which is large relative to total resource availabilities will undermine local ownership. One obvious way it might do this is through donors' use of *policy conditionality*. Conditionality stands in opposition to ownership, not least because it is apt to generate nationalist resentment of outside 'interference'. Where it exists, such hostility can add powerfully to perceptions of differences of interest as between donors and recipients. It can sometimes undermine the prospects of policy reform by creating a generalised suspicion of changes advocated outside which has little to do with the merits of the case. Donors contradict themselves when paying lip service to ownership while insisting on conditionality, for conditionality implies involuntary action, policies that would not otherwise be undertaken (otherwise the conditions are unnecessary) and which are agreed simply in order to gain access to money.

Technical 'cooperation' (TC) is another component which, as it is practised, often swims against the tide of ownership. Thus, the ODI study of aid effectiveness (1993, p.55) concludes that TC has been largely donor driven in sub-Saharan Africa, with little recipient involvement, limited local commitment and weak local ownership. Not coincidentally, a growing number of evaluation studies of TC are quite negative about its achievements. Berg, for example, chronicles the change from an earlier presumption of the beneficial effects of TC to a rising chorus of doubts and criticisms in the 1980s, on the grounds that it does not appear to be fostering greater self-reliance in recipient countries: "Despite thirty years of a heavy technical assistance presence and much training, local institutions remain weak and this type of assistance persists" (Berg, 1993:244).

A large-scale donor presence can weaken local impulses for self-improvement and development initiatives in more insidious ways too, as the present writer found in a 1995 mission to Tanzania (DANIDA, 1995). There, it seemed to me, the overwhelming donor presence, their large financial and other resources relative to local resources, the multiplicity of their projects and of their reporting and other stipulations appeared to have swamped local capabilities. Local officials felt overwhelmed, powerless to insist on local priorities. If they tried to stand up to a donor, more often than not it would use its higher political contacts in favour of its project, or would find another agency willing to implement it. For this reason, among others, Tanzania in 1995 displayed most of the less favourable characteristics of aid dependency.

Conclusion: there's a genuine aid crisis

We started by asking whether it is justified to view aid as being in crisis. Those who take such a view generally make their argument by reference to declines in the volume of aid, but by this criterion it is difficult to justify dramatising the situation as a crisis. We concluded

that aid statistics, especially the sharply declining trend in donor aid:GNP ratios, do indeed provide cause for concern but do not indicate an emergency. Total oda is falling in real terms but only slowly and from DAC donors - now overwhelmingly the most important source of assistance - it has still been slowly increasing. As of 1994, nearly twice as many DAC donors were still expanding their programmes as were cutting them. There has been some tendency for aid to be diverted from traditional developmental applications but most of this can be justified as in response to genuine needs and is not in strong conflict with developmental objectives.

However, if we look below the statistics of oda, at the underlying condition of the aid industry, we can see that it is indeed in poor condition. A turning away from post-war ideals of international co-operation in some major donor countries has coincided with a period when political support for aid as an extension of security policy has faded. Attitudes towards recipient governments have changed, with past waste and frustrations creating a less trusting, less tolerant view. The resulting desire to be more selective is powerfully reinforced by increasing budgetary stringency within most donor governments.

This situation has been aggravated by a paucity of evidence showing oda to have clear developmental and poverty-reducing benefits. It appears that aid has little ability to improve the performance of recipient economies. Its effects tend to be swamped, *inter alia*, by the effects of recipient governments' economic policies but donors have not discriminated efficiently in favour of those with good policy performance, nor does aid itself appear to bring much leverage over policy. Evidence that aid has a direct poverty-reducing impact is even weaker. Moreover, most of these negative judgements apply with particular force to African countries, the region on which donors have concentrated their greatest efforts over the last two decades and where there are special concerns about the negative effects of aid dependency. Indeed, one of features to emerge above is that many of the weaknesses identified are associated with *large-scale* aid. Aid, it seems, is like red wine: beneficial in modest amounts but toxic in large quantities.

When we turned to examine the place of aid within the dominant present-day view of the nature of development we concluded that the intellectual underpinnings of aid have been seriously undermined. The development model upon which the case for aid was originally based has been abandoned in the light of recent history, improved understanding and changing intellectual fashions. A good many of the early criticisms of the Right appear to have been born out by experience, not least the tendency for large-scale aid to distort incentives for private sector development. Aid appears less well suited for approaches to development which, alongside economic growth, stress human development and the quality of life as objectives, and which see development as essentially an internally driven process, propelled largely by private initiatives and market mechanisms. Furthermore, given the now widespread criticism of much past TC aid as ineffectual, oda similarly fits less readily into models of development which view human skill creation, institutional development, technological capabilities and the quality of policy interventions as among the key determinants.

Even accepting that the above view is one-sided and that, at more microeconomic levels, many aid projects appear to have been quite successful, the cumulative effect of the influences just summarised in eroding belief in oda has been powerful. Much past aid is now perceived to have been wasted, not so much as a result of the corruption which receives so much media

attention but by being placed within unfavourable policy and administrative environments (environments also likely to result in capital flight). It is worth recalling the main conclusion of Burnside and Dollar (1996): that aid *is* associated with improved economic performance when it goes to countries maintaining good-quality macroeconomic policies but that donors' use of oda to promote non-developmental objectives have prevented an efficient concentration of resources on such countries. Instead, donors have placed ill-founded faith in a conditionality which has not in practice brought much assurance of favourable policies within recipient countries.

In brief, faith in, and political support for, oda has been gnawed away. That is the true crisis. Let us therefore turn now to consider the future and to the changes in aid policy which might avert this crisis. What, first, are the prospects on the supply side?

II. THE FUTURE

Prospects for the future volume of oda

It is likely that the adverse trends in the aid budgets of some donors, reported earlier, are a reflection of the eroding political support for this type of expenditure just described. If the sources of weakness are not adequately addressed, it is possible to predict that more donors will follow suit and that a declining trend could well accelerate.

One reason for this pessimism is that virtually all donors are confronted by similar sources of budgetary pressure and these will inevitably bring heightened competition for scarce revenues. On the one hand, there is a rather general perception that, despite attempts to reduce it, the burden of taxation (along with the distortions which taxes bring) has become as high as electorates are willing to pay. If so, and if governments continue to give priority (reinforced in Europe by the movement towards monetary union) to the anti-inflationary strategy of reducing budget deficits and reversing the climb in public debt-to-GDP ratios, then the burden of fiscal adjustment will necessarily fall on the control of expenditures.

At the same time, most donor countries are, in varying degrees, confronted with powerful long-term pressures for larger expenditures: on state pensions (related to ageing populations), unemployment benefits (related in many cases to a long-term rise in structural unemployment) and other welfare payments, and the increased claims of interest payments on the public debt.

Even though aid budgets are everywhere small relative to total government spending, they are unlikely to flourish in the fiscal environment just described. The UN's 0.7% aid-GNP target is supposed to act as a safeguard against large budgetary cuts (at least in the large majority of donor countries which have not exceeded that target) but past experience gives no grounds for thinking that it actually offers protection. As Riddell (1996, pp.27-28) puts it:

> ... there is little evidence in the past, and less today, to suggest that the 0.7% target contributed in a major way to quantitative aid expansion. Some donors passed the target and continued increasing their aid; some donors never reached it and never looked as though they would; some donors whose aid volume always fell below the target increased their ODA/GNP ratio but then let it fall away; and, most recently, a number of those which exceeded an ODA/GNP ratio of 1% are seeing that (self-imposed) target slipping back.

Appeal to a 27-year-old target adopted by a General Assembly in which donors were in a minority in economic circumstances radically different from today's is simply not a weighty bargaining chip for a Minister of Development to use in arguments with the Treasury about budgetary allocations.

Faced with this likelihood of a continuing squeeze on aid budgets, there has been considerable recent interest in possible 'new' sources of aid finance.[15] The idea which has perhaps attracted the greatest attention is the idea of a tax on international financial transactions - the 'Tobin Tax'. However, conflicting purposes are ascribed to such a tax, which is seen both as a potential deterrent to speculative capital movements and as a possible source of revenue for oda (or other internationally agreed purposes). The dilemma here is that either the tax should be set high enough to deter speculation, therefore bringing in little revenue, or it should be set low in order to maximise revenue, in which case it will provide little deterrent to speculation. There would also be large problems with enforcement: near-universal adoption would be necessary if evasion were to be kept to acceptable levels. There would probably be technological problems of monitoring and collection, too, and a danger that the ingenuity of international financiers would always keep them ahead of the tax collectors.

The UN Law of the Sea Convention arguably both demonstrates the difficulties of achieving international agreement even on a relatively uncontroversial measure, having taken 18 years to negotiate, and the potential that exists for the international taxation of common resources. There are other ideas along similar lines, and also for various environmentally-based international taxes. The sale of all or some of the IMF's gold reserves is another frequently-nominated candidate. Indeed, it appears likely that a small part of these will indeed be sold during the next few years, with the proceeds reinvested to place the IMF's Enhanced Structural Adjustment Facility on a permanent footing. However, even this modest proposal has met fierce resistance from some donor countries and, in any case, the finite resources represented by the IMF's gold could not provide the basis for a significant long-term increase in global oda.

The basic difficulty which all these ideas confront is that the major industrial countries show very little interest in them:

> The states which would find themselves contributing most ... are precisely those whose conventional aid programmes are under greatest political pressure. They are also the countries where vested interests would be most adversely affected. In many of them, such as the United States, distrust of public-sector and multilateral intervention is widespread. The potential beneficiaries, for various reasons, have not progressed far beyond rhetoric. As a result, despite much activity by international secretariats and outside experts, no nation or group of nations has made concrete proposals for action, in an appropriate forum with power to carry the action forward (ODI, 1996, p.4).

Given this situation, it would be unwise to look to new international taxes as an escape from the constraints on bilateral aid budgets. However, given the past waste of much aid and

[15] For a succinct survey of the advantages and disadvantages of the leading contenders see ODI, 1996. This lists no less than 20 recent suggestions.

doubts about its effectiveness, excessive concern about aid volume may be mistaken. It matters more to improve the results obtained from the considerable volume of aid that remains.

Tackling the crisis

The most urgent task, then, is to raise the demonstrable effectiveness of oda. This would bring the twin benefits of (a) bolstering the defence of aid budgets and (b) raising the productivity of that aid which is available. But how might this be achieved? The strategy set out below has four elements:

* Reasserting an overriding developmental purpose for aid.
* Changing to donor-recipient relationships based on local ownership and acceptance of mutual obligations.
* Increasing the selectivity with which aid is allocated across developing countries.
* Tackling donor weaknesses which reduce the quality or productivity of aid.

REASSERTING THE DEVELOPMENT GOAL

It is well recognised that aid effectiveness has been undermined by a multiplicity of donor goals: developmental, humanitarian, commercial, financial, foreign policy and military. This has led to such malign practices as procurement tying and obstructed a more systematic approach to aid allocation. Complaints about this have long been commonplace but little improvement is observable, except that the ending of the Cold War has downgraded foreign-policy and security considerations to some extent.

This latter development and also the move towards freer systems of trade and payments do provide a political opportunity to strip out, or seriously downgrade, the increasingly redundant commercial and foreign-policy-cum-security goals which remain attached to aid programmes like long-dead crustaceans. Ministers of Development faced with a threat of budget reductions should offer a deal: acceptance of cuts in return for freedom to concentrate on the promotion of long-term development, with its implications of greater freedom to shift aid between countries (and to cut some off altogether) and to reduce procurement tying.

In urging this we have to be careful about how we interpret 'development', however. We should emphatically *not* equate it with economic growth. It deserves to be repeated that the moral case for oda rests ultimately on aid's ability to reduce poverty. Growth is necessary for poverty reduction but will not achieve that result unless it occurs within a policy framework which ensures that the benefits of the growth are widely shared.[16] We have

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[16] Modern approaches to the macroeconomics of poverty reduction are based on decomposing the growth and distributional components of the performance of an economy. Research suggests that most poverty reduction is a result of growth, rather than redistribution. This has been the case in much of Asia. However, where initially very inegalitarian income distributions are reinforced by policies which perpetuate the inequalities, as in much of Latin America, growth can occur in the midst of worsening absolute poverty.

suggested earlier that a good many donors still do not give poverty reduction much priority and that there is typically a large gap between best practice and what mostly happens on the ground. Taking poverty reduction more seriously would involve selecting more projects with explicit poverty-reduction objectives; favouring projects and programmes whose outputs are particularly likely to benefit identified groups of poor people (of which agricultural projects directed to the production of staple foodstuffs and the provision of primary education and basic training are obvious examples); working in close partnership with potential beneficiaries; and building distributional objectives into the design of all projects, e.g. by skewing technology choices in favour of employment creation.

There is probably also value in continuing the tendency of the last decade in channelling more poverty-directed oda through non-government organisations on the grounds that, being closer to the grass roots, NGOs are more likely than official agencies to reach the poor. The danger, of course, is that using NGOs as a conduit in this way will change the nature of these organisations in ways that impair precisely the advantages which were the reason for channelling aid through them in the first place. Moreover, it should not be taken for granted either that NGOs do have a comparative advantage in poverty reduction interventions or that official donor agencies should not attempt to directly reach the poor.[17] Most importantly of all, donors should withhold aid from governments pursuing seriously inegalitarian policies and should increase allocations to governments with a demonstrated commitment to the welfare of the poor.

Interpretation of the development objective needs also to take due cognisance of the importance for human advancement of more qualitative factors, e.g. as they relate to personal security and the rule of law, the observance of human rights (including the right to freely determine their own political status enshrined in the UN Charter), and reasonable access to health and education. It further needs to embrace the concept of environmental sustainability.

CHANGING RELATIONSHIPS

As characterised earlier, traditional relationships between aid donors and recipients placed few obligations upon the latter, apart from formal requirements for financial accountability, procurement and the like. In the case of the Lomé Treaties, ACP governments received oda as of right. In most other cases there was a presumption of a shared development objective and that governments would pursue policies consistent with a productive use of aid received. As also pointed out, that trust has been eroded, exemplified by the growth of conditionality, not merely by multilateral agencies but by bilateral donors too.[18] This has established the important principle of aid being based on *mutual* obligations. The problem is, as already argued, that using financial leverage appears not to be a generally effective way of securing better policies, even less of promoting human rights and parliamentary democracy.

[17] For an account of the evidence on the advantages and disadvantages of NGOs, and a sceptical evaluation of the use of NGOs in Norwegian aid programmes see Marcussen, 1996.

[18] On the use of conditionality by bilateral donors see Hewitt and Killick, 1996.

There has thus been a search for a more workable model but still based on the acceptance of mutual obligations. Within the World Bank, a major report on long-term development in Africa advocated placing aid on "parallel tracks", with programme and project aid being based on past performance in the implementation of governments' own programmes (World Bank, 1989b, p.14). Within the Bank's Africa department there has been discussion of the desirability of shifting in favour of greater use of *'ex post conditionality'*, implementing the parallel tracks approach.

A related but more radical idea is for the expression of aid relationships in *development contracts*.[19] The idea is that these would be based on mutual interests and embody reciprocal, long-term donor and recipient obligations. It would be for recipient governments to design the policy content of these contracts. They would formally commit themselves to these actions in return for donor commitments to agreed levels of assistance over a number of years, perhaps including compensatory and contingency mechanisms to ensure that policy reforms are not blown off course by external shocks. The assistance in question would not necessarily be confined to oda; it could also extend to debt relief and trading relationships.

Whether development contracts would be workable must be doubted, however. They rely on the right of either party to cancel the contract if the other party does not fulfil its obligations The threat of withdrawal would have to be credible. It is more likely that an unimplemented contract would be renegotiated and measures facilitating the recipient's ability to meet the terms of the contract would be included. The outcome in that event would be little different from present practice.

However, the most significant thing about the ideas just described is that they all embody the idea of 'ownership', of aid in support of policies devised by recipient governments. The evidence confirms the superiority of results obtained from government-initiated measures, with donors chiefly influencing the course of events through their intellectual contributions and practical help. This points strongly to the conclusion that the effectiveness of aid could be greatly enhanced by concentrating it more selectively in favour of governments which have decided for themselves to pursue and persist with a pro-development, anti-poverty policy strategy, a conclusion strongly reinforced by the evidence of the economic benefits of aid in countries pursuing 'good' macroeconomic policies. The recipient government's obligation in this case would be restricted to persevering with a policy strategy it had already adopted of its own volition.

INCREASING SELECTIVITY

However, if donors are to become more selective they need to develop objective indicators of ownership (and expertise in that area).[20] These indicators are liable to be highly specific

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[19] For treatments of this topic see Ofstad *et al*, 1991; Jayawardena, 1993; and Stokke, 1996, pp.101-04.

[20] A recent World Bank study illustrates this approach very well. *Bureaucrats in Business* (World Bank, 1995a) is concerned with the performance and reform of state-owned enterprises. Its conclusions are close to the position taken here: that there is little that conditionality by itself can do, that ownership and domestic politics are all-important, and that certain pre-conditions must be satisfied for effective enterprise reform. This raises the

to the policy area with which they are concerned, which means that there is a potentially large number of specific indicators that might be deployed. Consistent with the approach advocated here, the World Bank now makes a systematic attempt to relate its IDA lending to country policy and poverty-reduction indicators, although insufficient information is available to permit its methods to be assessed. A positive correlation is reported (World Bank 1995b, Table 9) between assessment of country performance and IDA commitment levels, with the top 20% performers receiving commitments of SDR 6.3 per capita in 1993/94-1994/95, against only SDR 0.5 per capita for the bottom fifth (although there was no evident correlation within the middle 60%). The Bank points out that commitments cannot be wholly determined by performance indicators, however: it is important to retain the flexibility to be able to respond to exceptional financing needs, e.g. for postwar reconstruction or debt workouts.

A broad-brush approach to the prediction of government ownership, would be to *use past performance as an predictor of the future.* This is what was meant by the earlier reference to ex post conditionality.

There are problems with this, however, mainly arising from the impermanence of political life. Governments come and go. They may also change course in mid-term, for good or ill. The concept of government ownership is difficult to apply when there is serious political instability. What, then, to do in countries plagued by chronic political instability? In the worst cases, it is probably an illusion to think there is anything at all to be done with development aid. In the absence of a tolerably settled government, or when the very institutions of state are under threat, the prerequisites for effective oda are not met and the most that donors can do is to respond to humanitarian needs until stability is restored.

It is in less extreme situations that the value of having indicators of government commitment would be of value. At the political level, these should be sensitive enough to differentiate between situations where a government is making a tactical retreat from a reform the better to manage opposition to it, and cases where the government loses heart and abandons the endeavour altogether. Indicators of ownership should also provide evidence on the extent to which affected interest groups have been consulted about the reforms in question, and the degree to which reforms command broad-based support.

Another test suggests itself: the government's willingness to prepare its own policy document formally requesting finance in support of reforms. This appears a basic requirement but it is one whose observance is startlingly sporadic. The IMF usually insists on drafting letters

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question of how to identify situations in which the conditions for successful reform are satisfied. Its authors therefore undertook research to identify predictive indicators. These included whether reform had come to be regarded as *politically desirable* by the government; that the proposed enterprise reforms should be *politically feasible*, seen as having two elements, the extent of control which reformers have over the policy-making process, and their ability to overcome resistance; and the *credibility* of the process, disaggregated into the reputation of the government for keeping its promises, the existence of legal and/or political constraints on policy reversals in this area, and the extent of any international constraints, e.g as constituted by treaty obligations or by membership of regional or other groupings.

of intent in Washington and this is surprisingly common practice within the Bank as well. Here, however, a distinction between willingness and ability is crucial. Governments that lack technical capability should be provided with expertise, if they ask for it. But donors should steer clear of governments which have the capability but such weak commitment to a developmental policy framework that they cannot put a persuasive request together.

A further aspect of greater selectivity is that *aid should be concentrated on those countries without adequate access to private capital markets.* As reported earlier, Lal (1996) attributes lack of creditworthiness among poor countries to the predatory nature of their governments but that is a very partial view. It overlooks the large structural weaknesses of these economies, the poorly functioning nature of their markets (particularly financial markets), the skill shortages and weak technological capabilities, and the tiny size of their internal markets. All these characteristics depress the prospective profitability of investment. They also make it less worth-while for potential international investors to incur the costs necessary for a knowledgeable view of local investment opportunities, leading to informational inefficiencies. Moreover, creditworthiness on private capital markets does not necessarily ensure sufficient resources for investments where social returns exceed private returns (e.g. primary education and health care), even less for poverty-reduction measures. There is, in other words, a market failures case for continuing with aid to low-income countries, filling a major gap which private capital is unlikely to occupy for some time.

In practice, as Riddell (1996, pp.29-30) points out, much aid still goes to countries with good credit ratings, so that the share of oda going to upper-middle- and high-income countries has actually been rising. Egypt, Mexico, Argentina, Brazil, Indonesia and Thailand are among the apparently creditworthy countries still receiving substantial amounts of aid. Donors have resisted the idea of a cut-off point of eligibility, with the United States and Japan particularly reluctant to have their freedom limited by any commitment to restrict assistance to poor countries: another example where mixing developmental, foreign policy and commercial objectives undermines aid effectiveness.

It should be frankly admitted that there is a difficulty in a strategy based on a more selective concentration of aid on the countries most in need of it and best able to put it to good use. A consequence of this would be to reduce the number of recipient countries (very probably to the disadvantage of Africa but to the advantage of some Asian countries), with the prospect that the Chosen Ones would receive substantially larger inflows than is typical at present. Yet one of the lessons emerging from our earlier discussion is that there are diminishing returns to aid to a given country: too much of it is liable progressively to generate the ill-effects associated with aid dependency. A partial solution would be to provide a larger proportion of oda in the form of programme support. But this would not entirely get rid of the problems because, as Younger found for Ghana, large amounts of programme aid are apt to have Dutch Disease effects and may well discourage private sector investment. Better use of a smaller global volume of aid is consistent with an enhanced developmental impact.

ADDRESSING DONOR WEAKNESSES

The fourth leg of a strategy to raise the effectiveness of oda is to address various specific donor weaknesses in the implementation of aid. These can be dealt with summarily because they are thoroughly familiar and the direction of desirable action is already clear.

The desirability of contributing more to local-currency recurrent costs has been urged and mechanisms for this have been proposed.[21] Various proposals have been made to strengthen donor agencies and reform the incentive systems that create pressures to spend regardless of developmental value. More and better *ex post* evaluation has been advocated, as well as improved learning processes from the results. Everyone says they are in favour of better co-ordination and a consequential amelioration of the problems of the proliferation of donors, projects and conditions, but actual progress is limited. There is a similarly long-standing struggle to reduce procurement tying but here too the trend is unclear.
In principle, one attractive route for avoiding bilateral donor weaknesses is to switch more aid to multilateral agencies. These are less beset by multiple objectives, better able to concentrate on maximising developmental effects. They are relatively immune from tying and some of the other practices which reduce aid quality. They probably have greater degrees of freedom in country allocation decisions. They are better placed to engage in constructive policy dialogues with recipient governments.

However: (1) Some multilateral agencies are more professional, efficient and non-political than others; this is not a blanket recommendation for more resources to any agency that happens to be international. (2) There would be obvious dangers of spawning yet larger international bureaucracies, with even greater concentrations of power *vis-à-vis* recipient governments. (3) There is little sign of a shift to multilaterals actually happening. Their share in total aid has actually declined in recent years (DAC, 1996, Table A3), and a reversal of this would be resisted by many donor governments Once again we come up against donors' multiple objectives, for it is the resulting loss of freedom to use aid for foreign policy and commercial advantages that have been among donor-government reasons for resisting larger proportionate allocations to multinational agencies.

The politics of the situation is the key, among both donors and recipients. If there is to be a fresh start, it is at the political level that it will have to be initiated. The approach of the millennium may be a good time to attempt a fresh start. There have been important policy improvements and political stirrings within recipient countries; and there has been a radical re-evaluation of security and foreign policies among donor countries. Both developments may permit some of the old obstacles to aid effectiveness to be overcome.

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[21] Back in 1979 the DAC published Guidelines on Local and Recurrent Cost Financing which made provision for a transition of financial responsibility from donor to government, with a gradual tapering-off of support. The (1989b, p.181) Bank report on SSA advocates donor acceptance of 'time slicing', involving agreement by a donor to finance a specified proportion of total financing in a chosen area.

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