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# 3

# Towards the Enhanced Effectiveness of Foreign Aid

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Until the Great Recession struck, one could notice a revival of interest in foreign aid in recent years. In the wake of the 2002 Monterrey Consensus, donors had been promising large increases, even doubling the volume they are willing to commit. Yet at the same time general scepticism about the past record of aid effectiveness has reached all-time highs. How do we reconcile this apparent paradox and what can we do to about it?

That increased interest in aid on the part of the major donors can undoubtedly be laid in large part at the doorstep of a US post-9/11 push, supported by Gordon Brown's enthusiasm for African development and by the Millennium Development Goals campaign of Kofi Annan, Jeffrey Sachs, and Bono. Although terrorists have generally been identified as educated and middle class, there is nevertheless a general agreement that countries in poverty, à la Afghanistan, Sudan, and Somalia, are more likely to provide a supportive environment. In any case, the US National Security Strategy Memorandum of 2002 was quite explicit in calling for a 50 per cent increase in aid while simultaneously admitting that 'development aid has often served to prop up failed policies'. Even the hoary Organisation for Economic Co-operation and Development (OECD) aid target of 0.7 per cent of gross national product (GNP), while not endorsed by the USA, had been dusted off. And, while actual allocations had been currently falling behind executive branch promises all around, the net result was still likely to amount to a substantial increase in rich countries' willingness to jack up resources for foreign assistance—and this at a time of severe budgetary constraints in most donor countries.

During the same period, we have witnessed a plethora of studies fundamentally questioning the effectiveness of aid in achieving the professed objectives of achieving growth and poverty alleviation in the third world. The 1980s and 1990s era of 'structural adjustment' lending, aid accompanied by conditions enshrining the so-called Washington Consensus of reforms, has by now generally been declared a failure, not only by academic critics but also by the major donors themselves. On the quantitative side of the ledger, aid has often caused a reduction in domestic taxes and private savings. Especially in sub-Saharan Africa where aid has been large, 13 per cent of gross domestic product (GDP) on average, it seems to have 'crowded out', instead of 'crowding in' private investment. On the qualitative side, the inflow of aid has frequently been associated with the appearance of the so-called 'Dutch disease'; that is, causing an undue strengthening of the exchange rate via an increase in spending on non-tradables and a decline in exportables, especially of the non-traditional, labour-intensive variety. But an even more damaging problem relates to an extended and more virulent strain of the 'Dutch disease', namely that aid may take the pressure off reforms—rather than inducing them—while enhancing a scramble for rents, high levels of corruption, and a reduction in domestic checks and balances (Auty and Mikesell 1998; and Sachs and Warner 2001; examples such as Nigeria and Venezuela abound; see also Richard M. Auty in this volume (Chapter 14) for a discussion on aid as a form of rent).

Burnside and Dollar (2000) have famously tried to dispel the overall gloom by claiming that aid still works in the presence of good domestic policies and, later, in response to critics, added the need for appropriate institutions to be in place (Burnside and Dollar 2004). But the attacks have continued to be relentless, led by Easterly (2006), but finding their most devastating crescendo in the exhaustive review of much of the cross-country econometrics literature by the International Monetary Fund's (IMF) Rajan and Subramanian (2005), concluding that aid has had a negligible and at times even negative impact on development. Among the several reasons usually given for such poor performance is the multiplicity of donors, each with their own axe to grind, the lack of nuanced country information at their disposal, the continued politicization of most aid programmes, and, most critically, the absence of more than skin-deep real ownership on the part of recipients.

There are, of course, still staunch defenders of aid, beyond such self-interested groups as aid administrators, non-governmental organizations (NGOs), and exporters. For example, Steve Radelet (2006) and others at the Center for Global Development, a Washington think-tank, have suggested that if we decompose aid and exempt from consideration both its humanitarian and long-term components, we can still find a positive impact on growth. And, of course, there is Jeffrey Sachs (2008) who argues fervently that aid can and should be usefully tripled, essentially by spending large amounts on health, education, and the like in pursuit of the Millennium Development Goals. Even Easterly, probably aid's severest critic, has no problem in still finding some merit at the micro or project level—for example, building schoolhouses or financing deworming programmes.

So, the basic question comes down to this: has bitter experience taught us that foreign aid—addressed to the recipient country as a whole and using





fast-disbursing policy-based loans as an instrument—cannot work and that donors should be satisfied with doing lots of specific identifiable little 'good things'. That conclusion would, of course, fly in the face of a controversy presumably settled many decades ago to the effect that it makes little sense to build a better schoolhouse if educational policies inside that house continue to be misguided, or for aid to support preventive health if the recipient's budgetary allocations freed up its own resources for a shift to military hardware. It should, moreover, not be forgotten that non-project policy-based lending has on occasion proven to be a useful instrument at the macro or country level. In the 1960s and 1970s, that list would include South Korea, Taiwan, Chile, Costa Rica, and Botswana; more recently, one can cite Poland, Ireland, and Slovakia. The reasons for not finding more such exceptions probably have more to do with the advent of diminishing returns to the ritual dance of the aid process, described below, than with the intrinsic demerits of the country programme aid instrument.

To its credit, the Bush administration seemed to have recognized the need to continue to view the country as 'the project' when, in 2002, it announced the creation of the Millennium Challenge Account (MCA), intended to provide more generous assistance, but only to countries which have passed sixteen threshold objective 'good behaviour' criteria. The concept which 'offers governments the opportunity... to undertake transformational change by designing their own reform and development programmes' has considerable merit, but the proof of that particular pudding is still in its implementation. Unfortunately, we have already witnessed a substantial number of country 'exceptions', that is, aid to strategic friends which do not necessarily 'govern justly, invest in their people and foster economic freedom'. Shifting the Agency for International Development deeper into the Department of State under a new director of foreign assistance—while also providing 'guidance' to the MCA—was hardly the way to depoliticize foreign assistance. Obama has been too otherwise engaged to focus on aid thus far.

Other efforts have been made, including those by the international financial institutions, to rescue country-wide programming efforts from the 'structural adjustment' era debacle. High on that list is the 'poverty reduction support programme' initiative of the World Bank—with its customary mirror image at the IMF—intended to correct earlier shortcomings by enhancing the ownership dimension of country programmes. But the effort to repair some of the damage by shifting to the poverty reduction support programme system, supposedly enhancing local voices and cutting the customary sixty conditions in half, has not really made much difference. The IMF and the World Bank have issued large, detailed manuals instructing recipients how to ask and what to ask for. At a 2001 Kampala meeting, fifteen African countries agreed that the poverty reduction support programmes were simply structural adjustment loans wearing somewhat different clothing.

Unfortunately, fundamental defects in how the foreign aid business is transacted have remained. It takes a willingness to act 'out of the box' if the fundamental problem is to be addressed. Admittedly, foreign aid at the macro or country level has generally continued to follow a deteriorating and self-destructive pattern. Donors, acting individually or in a World Bank-chaired consultative group setting, usually consult with recipients, determine their resource needs, and formulate reform programmes plus aid-level-related conditions precedent set to trigger, usually tranched, fund releases. A ritual dance then ensues: early on donors insist that a large number of conditions be strictly adhered to, but recipients also know that later the need to commit and disburse will overcome all else; a judgement is then rendered that enough conditions have been 'more or less' met so that disbursement can follow, if on occasion after some delay. Success can then be declared, and next year's instalment of the ritual dance can commence. Both parties clearly have an incentive to continue to fashion such relatively superficial agreements; and, what is worse, resources which were intended to ease the pain of adjustment accompanying stipulated policy change have the very opposite effect by taking the pressure off. The result is increasing levels of cynicism and fatigue concerning the entire process as the years go by. Donor personnel recognition and promotion continue to be tied to commitments and disbursements, not results; and recipients enjoy the pursuit of additional rents and the relaxation of fiscal discipline made possible by the inflows.

Is there a way out of the paradox? In my view, fast disbursing, policy-based loans remain the chosen instrument for donors to help achieve meaningful reforms in the third world. But what is required is a basic change in how the instrument is deployed, that is, via the opening of a new assistance window. While 'business as usual' country programmes will inevitably continue—donors will always have their domestic pressures and their pet projects—the new procedure would insist on donors acting more like bankers, that is, sitting back and encouraging would-be borrowers to approach only if and when they are ready with their own, internally generated, reform initiative, complete with self-conditionality. Donors, acting with one voice—either that of the consultative group or a United Nations Development Programme (UNDP) roundtable—would, of course, not be expected to sign on the dotted line, but the entire relationship would have shifted rather fundamentally.

There could well result long fallow periods in any given developing country case, but commitments, once made, would also be dependable and sensitive to the recipient's political as well as economic constraints. Donors would have to be ready to provide aid ballooning over periods long enough to be consistent with the adjustment requirements occasioned by the reforms. Given that the profession does not have anything close to agreement on what constitutes an ideal generalizable development model, traditional donor paternalism makes little sense. Each country case will require a nuanced interpretation of what two or three policy actions are both desirable and feasible over the next few years in order to remove some binding constraints or bottlenecks—not an extensive





Washington Consensus checklist. Passivity must become the watchword for donors.

It is generally agreed that the last time foreign aid worked exceedingly well across the board was during the Marshall Plan days following the Second World War. Conditions were admittedly unusually favourable: one donor (the USA), high recipient human capability and ownership, plus peer review. The current situation is admittedly more difficult but not beyond repair. The March 2005 Paris Declaration on Aid Effectiveness made some sensible recommendations on 'ownership' but insisted that change needs to come from within the developing world rather than emphasizing the need for a complementary change in the posture of donors. As long as some 'business as usual' bilateral country programmes can continue, the 'one voice' (consultative group) manning the new window should not be impossible. The provision of real scope for local initiative in assessing both the political and economic constraints which need to be tackled can be assumed to bring out local talent which already exists but is commonly underestimated and not 'in the loop'. On the other hand, when a recipient does feel it is still not quite ready to prepare a home-grown-reform-cum-self-conditionality package it can be encouraged to seek technical assistance. But it is important that such advice be divorced from the usual lending agencies and instead be lodged in third party, self-destructing teams, preferably financed by foundations or NGOs. Peer reviews, on a regional basis, would also be helpful but are not essential at the outset. In this fashion the above-described ritual dance would be replaced by occasional serious bargaining, vetting both the economic and political dimensions of any reform package. Donors would have to commit themselves to respond and supply the new windows with sufficient resources to make aid ballooning over a multi-year period feasible. They would also have to commit themselves to restoring the credibility of the exercise by discontinuing support in the case of non-compliance with an agreed-on, if now reasonably short, self-conditionality list.

The obstacles to this proposed new way of doing business should not be underestimated. Donors may be most reluctant to reduce supporting 'their thing' and speak with one voice; the feeding and promotion of aid agency personnel, accustomed to a rewards culture tied to commitments and disbursements, will continue to be an obstacle. And donor country parliaments, as well as the international financial institutions, will have to be willing to give the new window a real chance. Certainly the new process could be counted on to disarm those on the left who claim that foreign aid is too neo-colonial and those on the right who view it as a bottomless pit.

Recipients, for their part, may cynically wonder whether the new window is really more than just another donor fad and worry about those implied fallow periods. But, when all is said and done, the only reliable way to stop a corrosive ritual dance is to change the music.

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