Estratégia

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Democratic Governance and Foreign Aid

Introduction

In December 2007 there was a news article in the *Herald Tribune*[1] with the title "By disregarding Western advice, Malawi becomes a breadbasket". The basic message was that Malawi's president against the advice of the donors, in particular the World Bank, had decided to subsidise fertilizers and seed to promote food self-sufficiency and productivity in the agriculture sector. This decision was the result of an extremely poor harvest in 2005 which left Malawi totally dependent on food aid. So in the wake of this emergency Bingu wa Mutharika, Malawi's president, decided, according to the article "to do what the West practised, not what it preached". The result has been overwhelming. Again, according to the article, harvests increased from 1.2 billion tons in 2005 to 2.7 billion tons in 2006 and 3.4 billion tons in 2007. This result has been confirmed by an evaluation made by the British and American aid agencies. Yes, there has been a lot of rain, the report says, but the fertilizer input accounted for a larger part of the increase.

The above mentioned article is taken as a starting point for this paper on democratic governance and foreign aid. The paper will initially cover some aspects of European aid volumes, and then move to discuss the issue about aid conditionality and aid effectiveness, and finally deal with some dimensions of the debate on the so called aid architecture or the way in which aid is being administered and raised and its consequences for democratic governance.

European Union Aid and Africa

Everyone certainly remembers that 2005 was a year of great promises and pledges for more support to the development of the African continent. The debate culminated at the G8 Summit in Gleneagles, 2005. The pledge from that meeting was to double the total aid volume by 2010 compared to 2004, and that half of this increase should be allocated to sub-Saharan Africa. This implied an increase of USD 25 billion for sub-Saharan Africa. What has happened to the implementation of these promises so far?

Aggregated aid statistics for 2006 published by the OECD Development Assistance Committee, DAC, show that compared to 2005 the total aid flows from DAC countries and international organizations declined by 3 billion to USD 104 billion. As a share of DAC countries' Gross National Income (GNI) it declined from 0.33% to 0.30%. As for 2005, the figures for 2006 were strongly inflated by unusually high debt relief.

For sub-Saharan Africa an increase of 23 percent between 2005 and 2006 to about USD 28 billion was registered. Also in this case, most of the increase was due to increased

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[1] *Herald Tribune*: December 3, 2007.

debt relief, mainly to Nigeria, where it almost doubled to USD 10.8 billion in 2006. Excluding this, aid to sub-Saharan Africa increased by only 2 percent between 2005 and 2006, thereby returning to the volume of 2004.

If the debt relief is excluded, aid to Sub-Saharan Africa increased more rapidly in the years before the Gleneagles pledge than after. In the Monterrey Consensus a commitment was made by donors, including the Member States of EU, not to count debt relief as part of official aid flows (ODA). This commitment has so far only been kept by Norway.

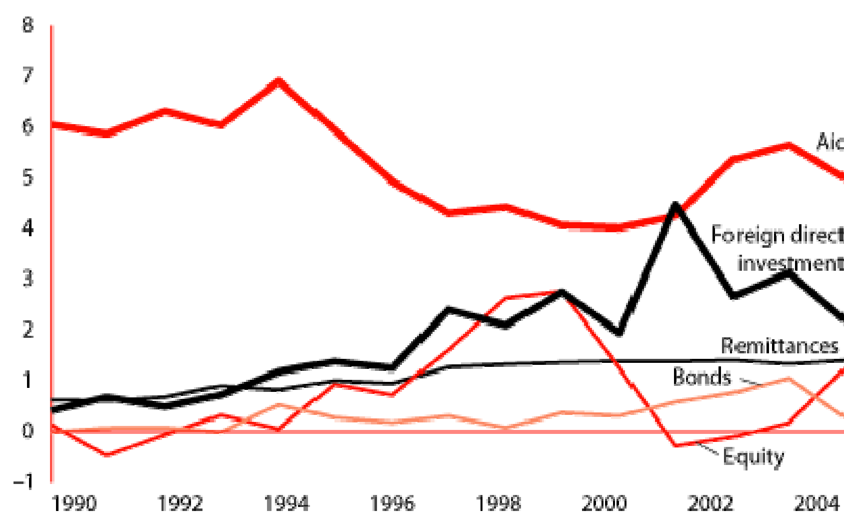
The 15 EU countries that are members of DAC have pledged substantial increases of their total aid, and a number of them have also made national commitments to reach intermediate levels of aid/GNI percentage in 2006 or later. According to DAC, 12 out of 15 of them are on track, but European NGO networks (CONCORD) point out that for seven of those 12 Member States this is due to increased debt relief and other non-core aid.

Projection of Member States ODA payments shows that if countries honour their ODA promises the biggest spenders in EU will be Germany and the UK, who pledge to contribute more than Euro 20 billion by 2015. If one looks to the countries that have the furthest to go to meet the 2015 pledge of reaching the projected target of 0, 7 percent, one will find Greece, Italy, Portugal, Spain, and Germany.

We can now see that the aid volumes have not increased substantially and that the promises made by the EU individually – to achieve 0, 51 % for those members which joined EU before 2002 and to strive to achieve 0, 17 % for those Member States which joined EU after – and collectively to achieve 0, 56% by 2010 as an intermediate step towards achieving the UN target of 0, 7% by 2015 is not on track.

The DAC Chairman has warned that donors will need to undertake major expansions of their core development programmes to Africa if they are to meet the target. The same message was emphasized during the World Bank and IMF Meetings in mid-April of 2007.

Resource flows to Sub-Saharan Africa, 1990–2004 (% of GDP)



World Development Indicators, 2006

The question of aid volumes is important because aid continues to play a major role as an external financial resource for Africa as can be seen in the table on resource flows to Africa above. Unlike the rest of the world where direct investments and remittances

have surpassed aid as the most important source of external finance, aid is still number one in Africa, and EU continues to be a major player there. EU accounts for more than 50 per cent of the world's total ODA, with about 75 per cent of the total EU ODA provided by its Member States.[2]

It is tempting to compare aid flows with the transfers of resources within EU itself. There are sometimes references to Germany and to the financial transfers which have been made between East and West since the beginning of the nineties. According to available data an average of 4% of the German GNP has been transferred annually. This is equivalent to almost 100 billion Euros per year, which can then be compared to the annual aid for Africa of 28 billion or 18 billion if we exclude debt relief.[3]

Aid conditionality

Moving to the issue of conditionalities and aid it is first of all important to make a distinction between different kinds of conditionalities. There is policy conditionality and there are other forms of more concrete, specific and/or targeted conditionality linked to the implementation of a particular project. In the European Union the reintegration of the East European states in Europe and the successful development of democratic institutions and economic reforms are often mentioned as examples of good policy conditionality. Before becoming a member of the EU the accession state had to legislate and implement a certain set of legal instruments including the Council of Europe conventions on human rights, anti-corruption etc. The process was by and large successful even if there were fears that the leverage of these mandatory requirements would fade away as soon as a state had become a member. This conditionality however had a clear incentive – becoming a member of the EU.

The question must therefore be asked if aid has a role to play for substantial changes in the governance structure of an aid receiving country or if it is other factors, which play into this transformation. If one looks to the past experience of aid and policy conditionality the concept of "Washington Consensus" has been the subject for heavy criticism. "Washington Consensus" became the code word for the packages of aid conditionality established by the World Bank and the International Monetary Fund in the nineties. It included budget reforms, inflation targets, reduced role of the state, privatization of important public utilities such as telecommunication and railways but also health and education and a liberalized foreign trade. Even the World Bank itself has questioned the results of this conditionality "package". In a review of its own policies "Economic Growth in the 1990s" there is recognition of the failures of their recommendations. One conclusion is that there are many different ways of reaching a specific goal, another that reforms must be selective and not linked to a pre-set list of policy reforms. Countries are different and need different solutions to reach the same goal.[4]

The "Washington Consensus" was understood to deal with economic reforms of countries. Some of its consequences had however far reaching policy consequences well beyond the economic sphere. It affected public institutions at national as well as at local level. In several African countries the advice to privatize a large part of the public sector met with a number of complications. Firstly, there was the pace with which reforms had to be implemented to meet the targets set by the international financial institutions so

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[2] "Development Financing through ODA" by T. Adison, G. Mavrotas and M. McGillivray in *The Millennium Development Goals: Raising Resources to Tackle Poverty*, Helsinki, 2005.
[3] " Berliner Republik" by C. Tham, Stockholm, 2007.
[4] "Economic Growth in the 1990s", the World Bank, 2005.

that they would release their loans. The hastily implemented sell-out of public utilities took place in an environment with weak markets and no regulatory bodies to oversee their activities. Secondly, the small existing "market" in many instances created an unhealthy or blurred mix between politicians' and private business' interest.

There may have been reasons for a breaking up of previous inefficient parastatals and loss-making public monopolies. These reforms probably should have been spaced over a much longer time period and complemented with the establishment of different kinds of checks and balances to create transparency and accountability.

Another serious political consequence was the far reaching effects for the poor created through the insistence on privatizing education and health services. The WHO Commission on Macroeconomic and Health[5] could already in 2001 document the adverse effects of introducing fees for primary health services. The paradoxical consequence was that in the poorest countries, including many African countries, the out-of-pocket health costs for the poorest people reached levels of 70 percent or more while in the more wealthy OECD countries a major part of health services were, and continue to be, funded within the framework of publicly financed health programmes.

After 1999 the debt relief initiative and in particular the HIPC initiative introduced a new conditionality, the Poverty Reduction Strategy Programmes (PRSPs), with their stress on poverty reduction and allocation to the social sectors. Albeit with good intentions the effects may have contributed further to the undermining of the formulation of national social policies.

The economic reforms described above were simultaneously developed with demands for democratic reforms in the wake of the end of the cold war. These two different "reform agendas" have since come to dominate the aid discourse. The fact that there is an inbuilt tension between the demands for democratic reform and the unconditional acceptance of a certain economic reform package has however not yet been sufficiently and critically examined by researchers.

Among researchers who have studied the relationship between development and good governance there continues to be a disagreement on issues related to methodology and inference.[6] The academic discourse often takes place against the backdrop of giving policy advice to development professionals. The focus is on interventions from the donor community and through foreign aid rather than on changes initiated by political forces inside a specific country, changes to be supported by donors.

In the discussion of conditionality the role of aid in building capacity for the implementation of international conventions, be they human rights, the right of children, women's right, and anti-corruption legislation has moved higher on the international agenda. To what extent should aid be made conditional to the implementation of the conventions? Should aid first and foremost be seen as a tool for building capacity? The dilemma remains what to do in cases where governments do not recognize their responsibility.

The promotion of democratic governance and human rights constitutes a central feature of the Africa-EU dialogue, as stated in the Joint Strategy. One example is the section covering the cooperation between Africa and EU on democratic governance. The basic approach is that EU is committed to supporting institutional development, knowledge-

[5] WHO Final Report, Commission on Macroeconomic and Health, 2001.

[6] "Good governance enough revisited" by Merilee S. Grindle in *Policy Development Review,* ODI, No 5 2007.

sharing and capacity building. The cooperation between institutions such as the European Court of Human Rights of the Council of Europe, and the African Court on Human and Peoples' Right will be promoted. This could be a more promising way to move forward than to attach a direct conditionality to the aid transfers. In cases of severe breaches of national laws and international conventions there are already (if not always) sanction regimes in place.

Aid effectiveness

In the above focus has been on policy conditionality. From different assessments of aid and its impact at country level we can say, quoting the Danish economist Finn Tarp, that "we lack the necessary understanding of the complex, country-specific links between aid, growth and development objectives such as poverty reduction. And the same could be said about democratic governance". And he continues "in the present drive to scale up aid, it is critically important to avoid making the mistake of the past of promising too much and contributing to the misconception that aid can on its own turn history".[7]

Ownership is a frequent term used in the discourse on foreign aid. Ownership, one could say, is the opposite of conditions. It has become an established truth that aid should be given in such a way as not to undermine national policies. This is at least the rhetoric. But the increasing number of donors from both national aid agencies and international and non-governmental organizations in almost all African capitals raises questions about the donor impact on "ownership".

According to some findings there is a decline in bureaucratic quality with increases in the number of donors. This phenomenon is linked to the increased demand for aid workers, also by non-governmental organizations whose work is financed by donors. Another well-known effect of aid flows are price increases on the domestic markets. A first step by donors, according to Nancy Birdsall at the Center for Global Development, "is to reduce the risk that aid from outside undermines existing and incipient institutions". [8]

Today's system of raising, allocating and deploying aid remains basically the same as that created more than 50 years ago. There are some major problems with that system. Because aid is needed in precisely those countries which are least able to use it well there is an inherent risk that aid will be used in a short-sighted and erratic way. Political changes in the donor countries are spilling over into decisions, which can have dramatic effects in the recipient country.

One problem which affects aid effectiveness is the extreme volatility in the flow of aid funds to particular countries. When recipients do not know if aid will be provided two, four or five years from now, they cannot make plans, which reduce the impact of aid. In a recent report by "European Parliamentarians for Africa" (AWEPA) the problem with aid volatility is addressed. Recognizing that Africa needs a gradual and predictable scaling up of aid AWEPA recommends that "European aid should be correctly managed to avoid unnecessary volatility that places an added burden on African nations".[9]

Much of the recent debate on aid effectiveness, according to Terry McKinley of the International Poverty Centre, has focused on the danger to macroeconomic stability of a

[7] "Aid Does Work but Beware of Great Expectations" by Finn Tarp in *Poverty in Focus*, October 2007.
[8] "Aid, Weak Institutions and the Missing Middle in Africa" by Nancy Birdsall in *Policy Development Review,* ODI, No 5 2007.
[9] "Tracking European Aid, Debt and Trade Commitments to Africa", AWEPA, Occasional Paper Series 14.

projected aid surge. There is a claim that high inflows of aid create a pressure for currency appreciation resulting in increased imports or inflation if spent by government locally (the so called "Dutch disease" effect). [10][11]

According to an evaluation of IMF data, referred to by McKinley, only a minor part of ODA to Africa was actually used to finance public spending, while nearly three-quarters went into reserves or debt buy-backs. A modest 27 percent of ODA was left to finance fiscal expansion. The risk of Dutch disease is therefore seen as a minor problem. On the contrary, according to him, it would seem appropriate to increase public expenditure as there is an acknowledgement that increased public investment could have an "in-crowding" effect on private investments rather than the other way round.

The real use of ODA in Sub-Saharan countries

PRGF countries, 1999 – 2005	
Government Expenditures	27 %
Retiring Domestic Debt	37 %
Reserve Build-up	36 %

Cited by McKinley

Aid effectiveness is also severely reduced by the growing complexity of donor-recipient relationships. Today there are over 200 official donor agencies, more than double the number 40 years ago, and the number continues to increase. The negative effects of donor proliferation have been recognized and initiatives taken to counter them. The thus far most ambitious attempt made by the OECD countries is the 2005 Paris Declaration on Aid Effectiveness. The initiative has resulted in an ambitious plan to reform the system of aid delivery.[12]

The key policy recommendations of the Paris Declaration rest on five pillars: ownership, alignment, harmonization, managing for results, and mutual accountability. A key aim of the effectiveness agenda is harmonization in order to decrease the transaction costs of delivering aid, reducing the burdens of developing countries required to manage multiple programmes and different donor procedures.

Within the framework of the Paris Declaration, the High Level Meeting in Accra in September 2008 will take stock of advances made in aid harmonization. A survey made by the OECD Development Assistance Committee (DAC) of 34 self-selected countries and a comprehensive set of donor organizations shows that there is a long way ahead to meet the commitments. The survey concludes that there are too many actors with competing objectives, especially in the poorest and most aid-dependent countries, leading to high transaction costs.[13]

[10] "Use Aid for Investing in the MDGS - Not for Reserves and Debts" by Terry McKinley in *Poverty in Focus*, October 2007.
[11] "What Undermines Aid's Impact on Growth?" by R.Rajan and A.Subramanian in NBER Working Paper no. 11657.
[12] "We're Working on It: Development Partners' Efforts for Effective Aid" by Jan Cedergren in *Poverty in Focus*, October 2007.
[13] 2006 Survey on Monitoring the Paris Declaration – Overview of the results, OECD/DCD.

The effects of aid on revenues

In the wake of the commitments made to increase aid to Africa the effects of aid on domestic revenues, state formation and quality of governance in developing countries have gained increased attention in the academic discourse. In a paper by Paul Collier the effects of aid on growth are compared with those of oil revenues. His conclusion is that "as a financial transfer, aid has been far more successful than a benchmarking comparison with the money transferred to African governments through natural resource revenues". He warns however that there is no reason to expect that a doubling of aid will continue to be effective if handled in the same way as in the past. Paul Collier focuses his analyses on the effects of aid on growth but he also recognizes the implications on the capacity of governments to formulate policies and to fund them.[14]

In a recent article by Alice Sindzingre the very structure and organization of taxation is discussed. She says that the fact that a state has the capacity to levy a number of its citizens is what defines it as a state. It is against this broadly accepted definition of the state that it is pertinent to analyze the effects of aid on the capacity to raise domestic revenues and, in the long term, to reduce aid dependence.

According to Sindzingre "Many least developed countries, however, are caught in a vicious circle where citizens distrust the state and are therefore reluctant to pay taxes, which thereby further weakens the capacity and credibility of the state". [15]

Mick Moore has looked into the circumstances under which increased dependence of governments on taxation might generate a governance dividend. Compared to dependence on a relatively broad tax base, the dependence of a state on oil revenue tends, according to Moore, to generate a number of 'pathologies' among which are i) autonomy from citizens, ii) external interventions, iii) non-transparency in public expenditure and iv) an ineffective public bureaucracy.[16]

The question is whether aid does have the same effects as oil revenues or not? Given the scarcity of research on the subject we may nevertheless assume that there are some similarities. Aid will no doubt increase a government's autonomy in relation to its citizens. It has sometimes been argued that it is easier to negotiate with aid donors rather than with tax-paying citizens.

From his analysis of aid versus oil Paul Collier draws the conclusion that with increasing levels of aid to Africa there must be a switch from policy conditionality to 'governance conditionality'. Such a recipient switch would reinforce the accountability of governments to their citizens. It would however, according to him, require an agreed approach by all donors ex ante and need to be formulated as international standards.

Aid and its effects on tax revenues and governance seem to be an area, which needs to be taken more seriously. If donors in general, and the EU Member States in particular, gave aid on terms which would reinforce the accountability of governments they would position aid more clearly on the side of reformers.

[14] "Assisting Africa to Achieve Decisive Change", Paul Collier, Centre for the Study of African Economies, Oxford University, April 2006.

[15] "Financing the Developmental State: Tax and Revenue Issues", Alice Sindzingre in *Developmental Policy Review*, September 2007.

[16] "Revenues, State Formation, and the Quality of Governance in Developing Countries", Mick Moore, *International Political Science Review*, no. 3, 2004.

Aid Architecture and innovative financing sources

Finally some words about the Aid Architecture and innovative sources of financing for development. Over the last couple of years, since the meeting on aid in Monterrey in 2002, there have been several initiatives to look at the sources and architecture of aid flows. The aim has been to increase its effectiveness and volume, reduce transaction costs, and increase ownership by recipient governments. The Paris Declaration, mentioned above, was set up to address some of these problems.

According to an UNCTAD report on aid to Africa in 2006, the present international aid system however is chaotic and lacks transparency. What is needed, according to UNCTAD, is a multilateral model similar to the Marshall Plan and to the European Community regional funds. The money should ideally be released in predictable tranches over a long term period.[17] What can the Joint EU-AU Africa Strategy do to facilitate such a move by EU donors?

The Commission is already one of the major players in the aid system. Every move to improve the system is therefore welcome. The new code of conduct which aims at reducing the number of donor countries in each country and in each sector is a move in the right direction. The challenge so far has been the lack of trust in the bureaucratic system of the Commission as such. The perceived inefficiency of the Commission and the continued politicization of aid do not, at present, make for big promises of a better aid architecture.

The deliverables in the Aid Effectiveness Package on joint programming and complementarity are to be implemented in 2008 and 2010. A first EU Donor Atlas showed however a concentration of aid in certain attractive countries and sectors. There certainly needs to be a much stronger multilateralization of aid to counter the distorting influence of individual donor preferences. This is a different governance challenge where Member States should also take responsibility to reform the Europe Commission – and international organizations – to improve performance in the desired direction.

New sources of finance will pose new challenges to the aid architecture. Innovative sources of financing for development that are additional to Official Development Assistance were proposed in Monterrey. In March 2006 France hosted the Paris Conference on Innovative Development Financing Mechanisms and in July 2006 France started applying the air-ticket contribution. The contribution of this mechanism in France alone will generate, according to early estimates, up to 200 million Euros annually.

Another innovative financing mechanism currently being introduced is the International Finance Facility for Immunization. The purpose is to raise money immediately on the international markets by issuing bonds. The system would allow for a front-loading of aid to make more resources available today.

A third innovative financing tool under discussion is carbon taxes. This is a tax on the consumption of fossil fuels. A carbon tax produces a double dividend: reduced carbon emissions and increased revenues.[18]

The common feature all of these different initiatives is their global character. The air tax in its present form will be collected on a national basis, and sovereignty over the use of

[17] “Economic Development in Africa”. Doubling AID; Making the ‘Big Push’ work, UNCTAD, 2006.
[18] “Meeting Global Challenges”, report by the International Task Force on Global Public Goods, Stockholm 2006.

the revenues will lie with the nation-states concerned. It is however also conceivable that the tax be collected by a multilateral institution, and decisions on the use of it be reached multilaterally. This would call for far more multilateral integration than we have at present. According to some observers the EU is now the only place where steps toward such a level of integration have been taken. [19]

Conclusions

When it comes to foreign aid to Africa significant progress has been made but much is left to do in meeting the commitments made by the EU and its Member States. Aid conditionality in the form of policy prescriptions often creates tensions with parallel demands for increased ownership and improved democratic governance. Aid effectiveness is reduced by the extreme volatility in today's flows of resources. It is also severely reduced by the growing complexity of donor-recipient relationships. The Paris Declaration set up to counter these effects has so far been more of an ambitious plan than a driver of change. Aid and its impact on democratic governance can be seen through the lens of taxation capacity. EU, being already one of the major players in the aid system, should move to improve the system by overseeing its own bureaucracy, by reducing the number of donors in each country and by using an aid delivery system that increases recipient governments' accountability and capacity to mobilize domestic resources.

[19] *Africa Focus Bulletin*, September 30, 2006.