

Findings

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Making Aid Work: the end of the cold war and progress toward a new aid architecture should make aid more effective

by Mark Sundberg and Alan Gelb

Since 1960 nearly \$650 billion in aid (in 2004 prices) has been provided to sub-Saharan African (SSA) countries by the OECD Development Assistance Committee (DAC) countries. And this number would be even higher if contributions from emerging non-DAC donors, such as China, India, and some of the Gulf states, were added to the total. Has all this aid been gainfully used to promote sustainable growth and development? This is difficult to answer because the links between foreign aid and countries' development are complex. However, the likely answer is, on the whole, "No." Historically, most aid has not been used very well. Much of it was never intended for development to begin with, and a large share went to war-torn and politically unstable countries where development gains have subsequently been lost. However, there is good reason to believe that substantive changes are taking place and that "more and better aid" is now going to finance development programs.

The changing aid picture

Total aid to Africa (defined as sub-Saharan Africa in this article) from rich countries represents the

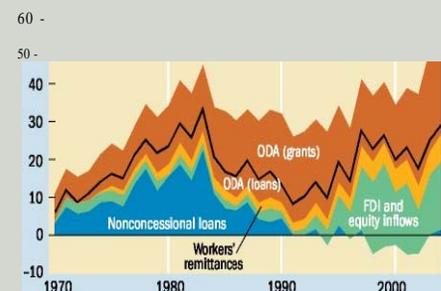
bulk of reported net financial flows to the continent, accounting for between 40 percent and 90 percent in any given year since 1970. While equity and foreign direct investments have grown significantly since the mid-1990s, they are highly concentrated in a small number of countries. For most countries, official development assistance (ODA) is still the largest single source of capital inflows,

Chart 1

Where the money comes from

ODA still outranks all other sources.

(reported net capital flows to sub-Saharan Africa; billion 2004 dollars)



Sources: OECD-DAC; and World Bank, *Global Development Finance* (2006).

Note: Negative net nonconcessional loans are the reasons for the dips into negative numbers, but positive FDI and equity inflows more than offset those negative net flows.

contributing nearly half of all net capital flows (see Chart 1). Following a major decline in the mid-1990s that coincided with the end of the cold war, aid has begun to increase again, although it is still below earlier levels. Per capita aid

flows are particularly striking. They declined to \$24 per capita in 1999 (nearly half the level seen in the late 1980s) but have since increased to about \$37 per capita (see Chart 2).

People typically think of aid as financing for development. But a large amount of aid is not intended for this purpose. OECD countries count a wide range of financing items as ODA, including such special-purpose items as costs linked to program administration, emergency and food assistance, technical cooperation, and debt relief. What remain are “non-special-purpose grants” that constitute what taxpayers typically consider foreign aid: financing for education, infrastructure, and health projects, as well as budget support for general financing needs. Over time, this share of aid going to *project and program support* has fallen. In per capita terms, the decline in project and program aid during the 1990s was significant, and it has not yet recovered.

Many factors have contributed to reducing the share of aid that finances development projects. The decline by more than one-third in the share of program and project aid in total ODA—from 63 percent to 41 percent—has coincided with increases in the share of administrative costs, debt relief, and emergency aid (see Chart 3). *Technical cooperation*, much of it spent on foreign advisors, has historically been the second largest component of aid—even though finance for training programs, analytic reports, and expert advice may never actually cross the borders of the donor country. Its share has declined but is still about one-fifth of total ODA, valued at \$4.5 billion to Africa in

2004.

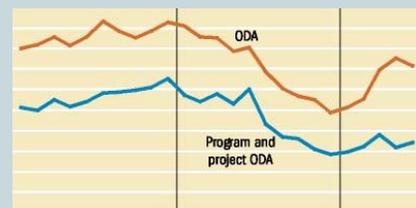
Administrative costs on bilateral aid have increased from an average of 5 percent to nearly 8 percent of assistance, in part because of the proliferation of agencies and countries involved in delivering aid—whereas 2 agencies and 10 countries provided aid to Africa in 1960, these numbers had increased to 16 agencies and 31 countries reporting to the DAC by 2004. Measures of donors’ administrative costs do not take into account the enormous administrative burden placed on the countries that receive aid. One informal estimate based on a survey of high-level policymakers suggested that as much as half of senior bureaucrats’ time in African countries is taken up in dealing with requirements of the aid system and visiting bilateral and multilateral delegations (World Bank, 2000).

Debt relief has increased fivefold since the late 1980s and today makes up 20 percent of all ODA. It is recorded as a special-purpose grant in the OECD-DAC system, which reflects the intent to make most debt relief *additional* to new ODA commitments. Valuing debt relief is quite difficult and warrants further work to improve measurement. But relief on liabilities that are not being (and often cannot be) serviced does not provide a new flow of resources for development, although it does reduce debt overhang. That said, relief for debt that is being serviced and clearly constitutes a claim on future resources may provide a future dollar-for-dollar cash-flow equivalent.

Chart 2

The impact of realpolitik on aid flows

Aid took a significant dip after the end of the cold war and is only now recovering. (net per capita real ODA flows to SSA; 2004 dollars)

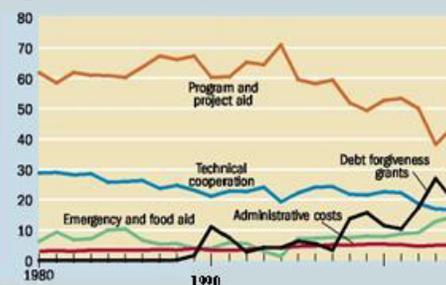


e: Note: Program and project ODA refers to total net ODA less special-purpose grants (technical cooperation grants, food and emergency relief, and bilateral debt forgiveness grants). Multi-lateral debt forgiveness grants are included because we assume multilateral debts were being serviced, making debt forgiveness equivalent to program aid.

Chart 3

The changing landscape of aid to Africa

The share of program and project aid has taken a big fall. (percent of net ODA by aid instrument)



Source: OECD-DAC database.

Note: Aid categories follow OECD-DAC definitions. Program and project ODA refers to total net ODA less special-purpose grants (technical cooperation grants, food and emergency relief, and all debt forgiveness). Administrative costs are for bilateral ODA only and have been imputed for Africa based on global levels. Administrative costs are not reported by multilateral agencies. Debt relief before 1988 was small (less than 1 percent of ODA) and cannot be distinguished by recipient region.

Emergency and food aid has also increased significantly, nearly doubling from 7 percent to 13 percent of total ODA since 1980. This type of aid is helpful in a crisis but does not generally contribute to financing long-term development.

Finally, a further practice that reduces the value of official aid is the tying of aid to donor country exports or firms. Tied aid is estimated to be 11–30 percent less valuable than untied aid because of price differentials between what

donor country firms charge and what would be available in the market (UN, 2005). Throughout the 1980s, more than half of all aid was tied in this way. There are indications that the share of tied aid is declining, but several donors no longer report how much of their aid is tied, making this difficult to confirm. However, based on what data are available, the UN estimates that tied aid reduced the value of bilateral aid sent to Africa by \$1.6–2.3 billion (out of a total of \$17 billion) in 2003.

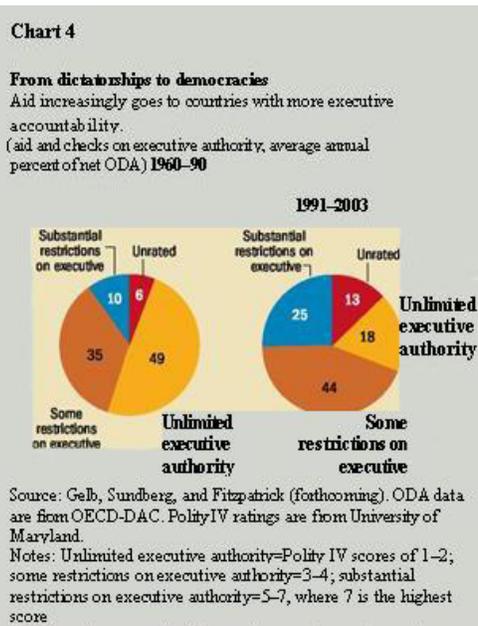
In sum, less than one-fourth of bilateral aid and 38 percent of total aid is provided as financing that can be directly used for projects and programs to build infrastructure, educate children, or reduce the spread of infectious disease. This excludes debt relief, a portion of which provides additional resources. In other words, development finance in the traditional sense is far less than what is reported as aid.

Where has the aid gone?

Aid has often been criticized for flowing to dictators and corrupt regimes with little interest in national development. And there is evidence that, during the cold war, aid was often provided for geopolitical reasons and sometimes even favored regimes with weak civil liberties and political rights (Gelb, Sundberg, and Fitzpatrick, forthcoming). Colonial ties have also historically been a determinant of aid allocation (Amprou, Guillaumont, and Guillaumont-Jeanneney, 2005). On the basis of measures developed by the University of Maryland to rate the concentration of power in the executive, known as “Polity IV,” about

half of total aid during 1960–90 went to countries that had “unlimited executive authority.” Only 10 percent went to more democratic countries with “substantial restrictions on the executive” (see Chart 4).

The fact that aid was often used to achieve geopolitical aims rather than foster development is corroborated by evidence about the principles that have guided aid allocation in the past—as measured by the extent to which countries and multilateral organizations based their decisions to give aid on need (poverty) and good management and governance.



(policy). Chart 5 shows aid selectivity trends since 1977. Both bilateral and multilateral aid demonstrate weak policy selectivity through 1991: aid was allocated with little weight placed on management and governance capacity. Poverty selectivity was also very low and even perverse for bilateral donors—that is to say, higher levels of poverty did not drive larger aid allocations. For multilateral donors, this was also true in the late 1970s, but selectivity im-

proved in the 1980s.

A great deal of aid was also allocated to countries that became politically unstable or endured civil conflict—in fact, 28 countries in Africa have experienced a total of 100 military coups or coup attempts since 1975, and 22 countries have experienced conflict during the past 30 years. From 1980 to 2002, one-fourth of all aid to Africa went to countries experiencing conflict. Nearly one-fifth of total aid went to countries later torn by conflicts that eroded prior development gains.

“Aid in the past was often guided by geopolitical considerations linked to the interests of donor countries rather than by development objectives.”

Many of the countries that have endured autocratic governments, civil conflict, and military coups have also seen high levels of unrecorded capital flight. In 25 countries in Africa, capital flight between 1970 and 1996 was estimated to total \$193 billion compared with \$178 billion in external debt, suggesting that several countries in Africa are, ironically, net creditors to rich countries (Boyce and Ndikumana, 2001). This is not to say that aid was the source of capital flight, but much of it was provided to countries from which capital flight was rampant.

Some encouraging trends

The good news is that in several respects these trends are changing significantly, which portends well for better quality and more ef-

fective aid in the future. Several developments help to underscore this. First, **aid is now going to governments with better civil liberties and political rights**. This is due both to greater aid selectivity and to the spread of democratic institutions and multiparty elections in Africa. Aid to countries with unlimited executive authority has fallen from nearly half to 18 percent, and the share of aid to countries with more democratic systems and checks and balances that place restrictions on the executive has nearly tripled.

Second, **policy and poverty selectivity have improved significantly**. The trend is most marked for multilateral donors, but bilateral donors are also placing much more importance on the quality of governance and overall policies in their aid decisions. These considerations have been made explicit in the performance-based allocation systems used by the multilateral development banks and by several bilateral donors.

Third, **there is a clear recognition of the need to improve aid quality** by reducing the number of agencies involved in disbursing aid, harmonizing aid procedures to reduce compliance costs for the recipients, eliminating tied aid, and aligning aid priorities with the countries' own policy priorities. The OECD's 2005 Paris Declaration on Aid Effectiveness is a key step in this direction. The *Global Monitoring Report 2006* (World Bank and IMF, 2006), which covers the performance of donors, developing countries, and the international financial institutions and their key responsibilities under the Monterrey Accord, is a further step toward mutual accountability.

Fourth, governance indicators suggest that **many countries have improved public resource management by strengthening fiduciary oversight**. The public financial management indicators that are being tracked for countries receiving debt relief under the enhanced Heavily Indebted Poor Countries Initiative show that many countries have improved their public expenditure management since 1999, and more indicators are being developed to track performance in other governance areas.

Finally, there is evidence of a **reversal in the high level of capital flight from Africa**, which has removed enormous amounts of much-needed financing for development. As political instability subsides and more countries turn to multiparty elections, and as growth picks up and income levels improve, domestic residents repatriate more assets (Collier, Hoeffler, and Pattillo, 2004).

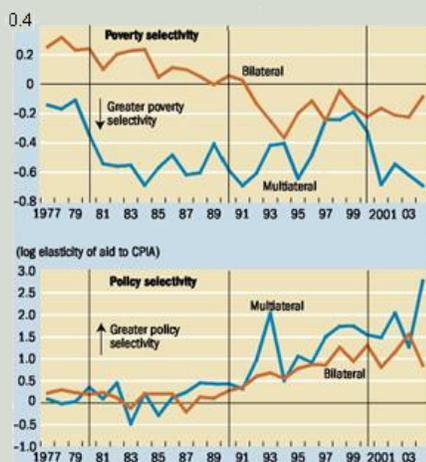
In summary, aid in the past was often guided by geopolitical considerations linked to the interests of donor countries rather than by development objectives. Not surprisingly, much of it was used to finance governments that did not have development as their first priority. Furthermore, much aid was not in a form that could be used to finance development (emergency relief and technical assistance are two examples). But changes since the mid-1990s hold clear promise for improving aid quality and effectiveness. The harmonization and alignment of aid under the 2005 Paris Declaration on Aid Effectiveness, as well as the trend toward improved aid allocation selectivity on the basis of need and policy quality, provide evidence of this. This "new aid architecture" can be simply described as aligning aid with country-owned poverty reduction strategies to finance priority social and infrastructural investments, conditional on delivering measurable results. New non-DAC donors and emerging donors, such as China and India, should also learn from DAC donor experience and improve aid alignment in order to enhance the impact of their aid.

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Chart 5

Reasons for giving aid

Donors are now more likely to emphasize need and democratic values when deciding where to send aid.



Source: Authors' calculations.

Note: A positive and rising value for the policy indicator shows allocations to countries with better governance (as measured by the World Bank's Country Policy and Institutional Assessment (CPIA) index), whereas a negative and falling value of the poverty indicator (using income per capita as a proxy) indicates greater allocations to poor countries.

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