

Some comments
on
Moving out of aid dependency

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The development dilemma

Aid is a foreign policy tool directed to some sectors/goals

Development strategies encompass a wide array of investments

Flexibility needed in the development strategy over time financed by aid with little conditionality

Dilemma: How does a low income country find the resources and policy space with country ownership and flexibility for a complete development strategy?

Which is the right approach to development?

- Critics of PRSP and PRGF point towards the bias towards social sectors squeezing out the more traditional development dimension of ODA
- The approaches are basically “Washington Consensus” + governance combined with short-term social safety nets
- Consultation in PRSP is not “ownership”

Issues in development strategies

- Policy advice to developing countries is at times inconsistent with long-term development objectives.
- Poverty alleviation programs sometimes too narrowly focused on temporary safety nets and not embedded in the long-term focus on providing self-sustaining growth and employment

Policy advice coverage maybe incomplete to cover crucial aspects of development policy for the preparation of meaningful *national development strategies* for a coherent framework of growth with poverty reduction

Alignment issue

Several guidelines and toolkits available to facilitate the realization of the MDGs, such as

- the PRSP Source Book which guides the PRSP process
 - UNDG's MDG toolkit, UNDP's How to Guide for MDG-based National Development Strategies
 - and the UN Millennium Project Handbook for Preparing Strategies to Achieve the MDG's,
- Useful in policy focused debates, are not internally consistent in their policy advice. Many elements of PRSP programs have not sufficiently incorporated current or planned country commitments to the MDGs strategies.

Example of Uganda to illustrate problems with present approach

- Uganda is an aid dependent economy
- Following the HIPC initiative substantial aid provided through budgetary support for social expenditure
- Failure to absorb aid completely as aid not used for building up productive/trade capacity due to conditionality on the use of aid
- Instead liquidity generated by aid led to build-up of reserves and costly sterilization – build-up of debt with a high interest cost

Classification by aid absorption and expenditure

	Not Spent	Partly Spent	Mostly Spent	Fully Spent
Not absorbed	Ghana (0,7)			Tanzania (0, 91)
Partly absorbed	Ethiopia (20, 0)		Uganda (27, 74)	Mauritius
Mostly absorbed				Mozambique (66, 100)
Fully absorbed				

Source: IMF (2005). The Macroeconomics of Managing Increased Aid Inflows: Experiences of Low-Income Countries and Policy Implications

NOTE:

“Spent” variable = Non-aid fiscal balance deterioration as percent of incremental aid inflow

“Absorb” variable = Non-aid current account deterioration as percent of incremental aid inflow

Resolving the dilemma

- Flexibility in the use of funds for overall development expenditure
- Institutional building takes time – no quick assessments for aid allocation – better time frames
- Investment in the creation of a Knowledge Bank of South development experience
- National Development Plans

Use of donor funds for export diversification, infra-structure development and financial sector reforms - import content of investments essential to shield the economy from their liquidity impact and as a secondary effect increase the demand for credit by the private sector.

Issues in Aid Financing

- Donors tend to move in and out of countries together – aid pro cyclical - More volatile than fiscal revenue – gaps bet commitments and disbursements – selective – donor orphans and darlings
- Alignment to the PRSP and PRGF with aid financing – Q: Is it a complete development paradigm
- How to ensure a longer time horizon for stable, predictable and durable aid?
- Aid commitments an issue
- Simpler aid delivery mechanism

Other dilemmas

Inconsistency between resources needed for development and the DSA for low income countries

FDI mostly in extractive industries

Limited access to other sources of financing

Aid architecture

- Complex uncoordinated and fragmented system lacking in any centrally directed political or technical framework.
- Variety of aid instruments and associated agreements with a large number of donors for aid coming through the budget or via projects.
- The number of donor missions in each recipient country is mind boggling leaving little time, space and human resources for independent policy making.
- The indicators that need to be monitored vary and jointly can be very high raising issues of consistency between indicators and the call for rationalization and harmonization of indicators.
- Similarly, efforts are needed to streamline conditionality.

Aid architecture governance patchy

Little voice for recipient countries.

- World Bank is governed by a Board, in which national voting share is dominated by the industrialized countries
- Governance of UN agencies, funds and programs all have their own governing bodies or executive councils, usually on a one member one vote basis.
- Bilateral flows dominate the composition of aid but bi-laterals offer no formal mechanism for the voice of recipient countries to be heard. Bi-lateral donors are answerable to parliaments in their countries.
- The EU program - mixed bag. Half of it is spent under the authority of the EU budget, agreed jointly by the Council of Ministers and the European Parliament and half is provided under the provisions of the Cotonou Agreement