3

Policies for International Co-operation

3.1 Trends in Aid

What are the implications of the discussion thus far for international co-operation? The prospects for aid volumes are not all that clear. There is Congressional opposition to aid in the US, and appropriations for various purposes have been cut, even if so far by less than was once feared. At the same time, the largest donor, Japan, has reiterated its commitment to continued increases in aid; several other donors remain similarly committed, while yet others expect no change or modest declines. Insofar as aid is under threat in volume terms, it is mainly in the US that there is strong opposition on political grounds. In other countries where declines may be in prospect, it is more a result of pressure on public expenditure, and of governments either not wishing to raise taxation or feeling the need to curb public borrowing.

In addition, within aid budgets, there is growing pressure to allocate aid to short- rather than long-term development priorities. Bilateral aid for emergency relief and refugee assistance from members of the OECD Development Assistance Committee (DAC) rose from $1 billion in 1987 to $3.5 billion in 1994; including emergency food aid and contributions for emergencies to multilateral agencies, total emergency aid was about $6 billion, or some 10% of all aid in 1994; aid for developing country refugees alone took $2.5 billion. While total Official Development Assistance (ODA) rose from 1987-92, in 1993 it fell back to a level below that of 1991, but rose once more in 1994, to $59.2 billion. Total assistance for relief was just under 4% of ODA in 1987; its rise to 10% in 1994 thus removed 6% of ODA from longer-term purposes.[53]

While moderate declines in aid may not create difficulties for many aid recipients, they clearly can for the least developed countries and for much of Sub-Saharan Africa, where annual budgets, payments balances and capacity to service debt are often heavily reliant on aid. There are mixed prospects for aid to Africa: possible US cuts in its contributions to IDA and the African Development Fund (the African Development Bank's soft loan window) do not augur well. One or two donors cut their contributions to the 1994-96 Special Program of Assistance for Africa chaired by the World Bank, but Japan increased its input, and the overall funding level will remain marginally up if existing pledges hold. Some European donors (the UK among them), have cut their contributions to the European Development Fund (EDF) but have done so expressly because they are concerned about the effectiveness of EDF assistance, and will increase their bilateral funding with the amounts taken from the EDF. Overall, aid to Sub-Saharan Africa seems set to remain close to current levels, though there may well be closer scrutiny of countries not deemed to be making adequate efforts of reform.

Problems remain with international treatment of African debt. The G-7 Naples summit in 1994 made some new offers on bilateral debt, but with fairly tough performance conditions that will take time for countries to meet. A large proportion of several African countries' debt is multilateral and not currently open to rescheduling – 66% of Uganda's debt, for example. Further debt measures are desirable to get African countries out of the cycle of renegotiations. The proposals on multilateral debt put forward by the British Chancellor, Mr Kenneth Clark, at the Commonwealth Finance Ministers meeting in Malta in 1994 represent an important initiative.[54]

Even if aid for long-term development were not shrinking, making it more effective would be an imperative for donors and recipients; and it is all the more so in present circumstances. The question is, how might that be done?

3.2 Changing country allocations of aid

A natural response would be to think of changing the country allocation of aid. A significant proportion of aid goes to countries whose income levels are relatively high, and which cannot in many of the better-off cases be said to need aid by most criteria: they have reasonable payments balances and levels of foreign reserves and savings, are creditworthy for commercial borrowing, and are if anything only in need of a certain amount of technical assistance. If aid were reallocated from such countries to those where the usual economic criteria for aid apply, there would certainly be more to go around. On average for 1992-93, 20.3% of aid was allocated to lower-middle-income countries (per capita income \$676-\$2,695 in 1992), 2.6% to upper-middle-income countries (per capita income \$2,696-\$8,355), and 4% to high-income countries (per capita income above \$8,355).

There are, however, only limited prospects for any such changes at present. Where significant volumes of ODA are flowing to better-off countries, it is nearly always bilateral, and nearly always because of political or strategic motives on the part of the donors. In fact in recent years, the DAC has "graduated" a number of high-income developing countries, i.e. agreed to classify them as not aid-eligible, and taken a decision in the current year to examine more such cases. The DAC could not agree, as some donors wished, to lower the per capita income "threshold", for example to the IBRD graduation level (some \$4,000 plus), i.e. the point above which Part II members of the World Bank cease to be eligible for International Development Association (IDA) terms, which are highly concessional, and can only borrow on IBRD, only marginally concessional, terms.

The DAC did adopt a wider set of criteria for graduation including a variety of social and economic indicators in addition to per capita income; but these criteria will be employed on a case-by-case basis, and judgmentally, with no element of automaticity. It has been evident in discussions within the DAC that several donors have little desire to circumscribe their freedom to make ODA available to particular borrowers as they see fit.

In any case, it is not obvious that this is the right route. There are no apparent means that would command donor consensus of selecting significant numbers of recipients for graduation. Many would say, too, that the results of aid are sufficiently mixed that just giving a class of countries more aid, without changing its character, would not help much. The problems of deciding who to allocate the aid to would also remain. There is no real alternative to improving the effectiveness of aid.

Some reallocation of aid among countries will take place, for example, if IDA resources become more limited. Individual donors vary their bilateral aid levels overall and to particular recipients. But they have too many foreign policy and commercial reasons for aid-giving to make country re-allocation of aid on developmental grounds at all easy. It is hard to make a developmental case in China's current circumstances, for example, that it should receive large or indeed any IDA allocations, given its savings, reserves, and balance of payments position, and the huge inflows of FDI; but Japan, now IDA's biggest supporter, would currently resist any major change in China's share of IDA. It is only through the route of effectiveness that there may be a prospect of rechannelling of aid on a reasoned donor-wide basis.

3.3 Improving the effectiveness of aid[55]

Some broad issues

One key to improving effectiveness is understanding where aid has gone wrong – when it *has* gone wrong; one must always remind the aid pessimists that a large share of aid has been successful. Recent reviews of aid projects and structural adjustment lending make it starkly clear that one principle which should be high on the list for improving effectiveness is *recipient ownership of and commitment to* aid activities. Over and over again it is found that a critical aspect of unsuccessful aid operations is the lack of such ownership and commitment. It is true of structural adjustment policies, it is true of many projects, it is particularly and emphatically true in Technical Co-operation (TC).

Studies of aid effectiveness show that governments often attach low priority to TC, do not monitor TC activities centrally, do not have a separate record of TC; they appear to regard TC as a donor preoccupation, something they have to accept as almost the "price" of receiving the capital aid which they really want. TC is a prime example of aid which is often donor driven, and whose frequently poor record has much to do with that fact. The donors are now deeply concerned about this part of aid. Of course it is not all bad by any means and has a number of successes to its credit. Nevertheless TC is a quarter of all aid to Africa, and an even larger share of global aid, and both donors and recipients are right to be concerned. It is particularly important because the fate of *institutional development*, another key aspect of effectiveness, is intimately bound up with TC.[56]

Improving recipient ownership and commitment requires a number of things: more participation by recipients in the design of projects and programmes; greater efforts by donors to familiarise themselves with recipient conditions, social, political, institutional as well as economic; greater use of recipient expertise about development needs, possibilities and prospects. Policy reform under one-sided conditionality, expressing donor wishes and recipient acquiescence, is not policy dialogue. It is monologue plus money. It is unlikely to work.

One goal is the *sustainability* of aid activities. ("Sustainability" is used here to mean the capacity of aid activities to survive after the period of donor funding is complete.) Donors may well wonder what they have contributed to development if, a few years after their projects and programmes are complete as far as their financing is concerned, recipients abandon them. Studies of projects have shown a number of things to be important to sustainability: technology, which should be suitable to local conditions and the experience of local managers; administrative arrangements, which should strengthen rather than compete with national administrative structures; and accord with national priorities. Recipient ownership and commitment are affected by all of these.

It has also frequently been suggested that recipients should play a greater part in evaluation – suggested, but not much followed. A proposal has been put forward about TC in particular, that it should be subject to a combined process of *assessment, evaluation and identification, led by the recipient government*, or an agency such as UNDP in conjunction with the recipient. A national TC assessment would be prepared at regular intervals, and used as the basis for TC bids from donors; evaluation conducted within such a process would focus it on TC's developmental impact from the recipient's point of view. It could also be a basis for untying TC, a desirable goal, though one which is well-known to be difficult for donors to accept.[57]

The proposal has much in common with the suggestion that aid in general for individual countries be related to a *"Priority Investment Programme"*, prepared by the recipient and agreed with the donors, which then becomes the basis for offers of aid. This was originally suggested by the World Bank as a co-ordination measure; but it would also serve to enhance the recipient's sense of ownership, as would the TC process just mentioned. A broader approach of this kind is currently under consideration in the Development Assistance Committee of the OECD. Making aid much more recipient centred is a high priority in the aid community.

A large factor on the recipient side accounting for poor aid performance has been the policy environment. There is hope for considerably improved aid performance in future as a result of the sweeping changes in developing countries' economic policies, which have come about through their own efforts and through the *structural adjustment programmes* led by the World Bank and International Monetary Fund.

In the context of macro-economic imbalances (e.g. high inflation, fiscal deficits, and balance of payments deficits), the Bank and the Fund deserve credit for assisting numerous countries to move towards a better policy stance. But credit is not all they deserve; they are also open to criticism. If some of the results of structural adjustment have been disappointing, part of the reason has been errors in their programmes, particularly in structural adjustment in Africa. While performance in some African countries is beginning to look more favourable, in several the economies are not yet responding to treatment (and some have not tried it at all consistently). There has been one overall failing of structural adjustment lending in Africa and elsewhere: the attempt to correct deep-seated problems in too short a time. The sources of this failing are numerous: some of them lie in the design of programmes, and include overestimation of the extent or speed of response of economic variables, or over-optimism about the pace and strength of institutional change. Some stem from the inflexibility of programmes, and the concentration on demand rather than supply measures – indeed, had the latter been more in evidence, it would have been even more obvious that the time needed for adjustment was much greater than assumed.

A list of more detailed troubles afflicting several programmes in the early years of adjustment would include the following: excessively exclusive reliance on reforms in prices and market signals without supporting measures of other kinds; insufficient attention to areas where greater public investment is needed (relative to reforms in the state sector); over-emphasis in financial reform on the views of the "financial repression" school, misplaced confidence in the effects of interest rate increases, and lack of appreciation of the realities of formal and informal financial markets and structures; lack of understanding of the prospects for privatization; undue reliance on, and over-optimism about the prospects for, traditional exports, and lack of attention to policies for expanding manufacturing enterprise and other non-traditional exports; insufficient attention to the fiscal consequences of devaluation packages; conflicts between short- and long-term policy requirements, perhaps most particularly in the field of *investment in human resources*; and inadequate efforts to protect the poor and public programmes beneficial to them from the consequences of reform.

Many of these mistakes in policy have been revised. Certainly there is much greater attention today to the needs of the poor under structural adjustment, even if policy has not yet gone far enough. The latest World Bank study of African adjustment speaks of "reforming financial reform", and admits that there has been excessive reliance in the past on "quick fixes". It admits that there were some fallacies of composition in the advocacy of expansion of traditional commodity exports: that supply expansion might have made sense for individual countries in some products, but not if several countries did so at once – what the study calls the "adding up problem" – and suggests some changes in trade adjustment policies, including supply-side measures. A new realism has dawned on the length of time that liberalising reforms will take, and on the importance, and intractability, of institutional reform and strengthening that is needed.[58]

The policy environment that prevailed prior to adjustment was by common consent inimical to development. The fundamental thrust of macro-economic reforms has been right, in the sense both of what required correction and of (many of) the measures introduced to achieve that correction. So have many of the more detailed reform measures. But in some areas the philosophy underlying reform, that getting prices right will solve most of the problems, has been exaggerated. Prices of course do have to be got right; but so must many other things besides, including things that have to be done by governments.

In the end, within structural adjustment, there are potential conflicts of priorities which have not been resolved. Arguably there has been, for example, excessive concentration in African agriculture under structural adjustment on the promotion of cash crops, rather than on smallholder agriculture and food crops. The latter require a range of policies and programmes beyond market reforms which have not adequately been attended to: research and extension, agricultural services and inputs including credit... The list is well known. They require in turn attention to institutions and governmental capacities, and a long-term involvement which has so far not characterised the adjustment process, indeed to which the reforms that have taken place so far are a prelude – a necessary one, but only a prelude. If productive capacity and improvement of the lot of the poor are the objectives of aid, these problems deserve far more attention than they have so far received. In this context, the new Consultative Group to Assist the Poorest (CGAP) launched in 1995 is a valuable start; the World Bank will contribute $30 million, and other donors possibly $70 million, to a fund intended to reach the poorest through institutional micro-finance programmes. However, the full range of necessary measures is considerably wider.[59]

Three inter-related topics stand out from the analysis of this paper: human development, governmental capacity, and the private sector. Discussion of the role of aid in these three areas closes the main paper. There is some concentration on Africa – it is no secret that aid has been less successful there than elsewhere. But the lessons of past aid experience have broad applicability.

Assisting human development

It has been argued above that human development must be a main concentration of the overall development effort – both as an ambition of development, and as an ingredient of the process. It has also been argued that several elements of it are paying propositions for government – current revenue costs are recouped fairly quickly by resulting savings. Funding for human development is not "welfare spending". The following are some of the means by which international co-operation can assist:

- Helping countries to *formulate HD strategies*. There is new expertise on human development but this needs to be tailored to a particular country's priorities and circumstances. Donors should be ready to help mount studies leading to new HD strategies, taking account of both humanitarian and productive objectives. Local experts should play major parts in such work, supplemented as necessary by overseas personnel.
- Assisting *skill development*. This needs *much* greater priority in HD strategies.[60] While basic health and education for all should become universal, phasing the approach to universality must take account of costs, and the competing claims of skill development. Establishing priorities here, and policies to encourage firm-level training, are part of strategy formulation; they may also suggest roles for TC. Donors can also support free-standing training institutions where these are appropriate.
- Assisting *financing* of HD. The most general means is for donors to fund a "time-slice" of a particular ministry's work, or selected programmes within it, i.e. to finance a share of annual capital and recurrent expenditures for a period of two to three years, after satisfying itself that it is in accord with the country's policies. Progression has to be built in so that the donor's funding would gradually be replaced by the recipient's. Donors can also assist with promoting private sector and NGO provision of services, with voucher schemes, with community-based services, and so forth.

- *Getting user fees right.* An important part of financing today is user fees or charges. This field deserves greater care than has sometimes been exercised. While fees can properly be used to recover costs from those who can afford to pay them, they have sometimes been introduced without appropriate knowledge. It is essential that any charges introduced should not damage the interests of the poor. Some introduction of user fees has undoubtedly created hardship. At the same time, if governments are strapped for cash, the alternative to charges may be reduced services. Difficult choices have to be made: but at least they should be informed choices.

- Assisting *commitment.* Donors can and do assist countries in building constituencies for policy change. This may be particularly important when reallocation of existing patterns of expenditure is necessary, but interest groups resist.[61]

- Assisting with *new technology* development and *new approaches.* New techniques of distance learning, methods of setting up "open universities", new learning methods including the use of computers, new methods of text-book production; new health technologies; new approaches towards population, combining maternal and child health and family planning, and relating to other HD programmes, especially female education.

- Assisting management and the heightening of *efficiency* in public sector programmes. This has much to do with the improvement of governance – *see* below.

- Greater *donor co-ordination and complementarity.* A number of donor agencies have announced major increases in future funding for HD. But each agency has strengths and weaknesses in what it can and will do. More and more efforts to fund HD without better co-ordination may yield disappointing results. Ideally donors would join forces with each recipient in designing an HD strategy, and would then co-ordinate assistance with appropriate division of labour among themselves.

Strengthening governmental capacity

Many developing countries lack effective government and administration, and as a consequence development policies and their implementation leave much to be desired. There are also problems of transparency and accountability in some countries, even questions about the commitment of government to development itself. Without more effective government, many countries will not achieve their development. The private sector is not a substitute for good government and the efficient management of resources; in its earlier stages, it needs good government to become established. Provided donors wish to help movement to change in more promising directions, there are a number of things they can do:

- *Assist civil service reform,* which usually requires downsizing, and improving the quality and conditions of service of personnel. The civil service must also be permitted greater roles in policy formulation, and often needs greater expertise especially in areas of macroeconomic policy. Taxation policy and its implementation are also important areas for donor support.

- *Assist the emergence of transparency and accountability.* Civil service reform and support for the judiciary, the legislature and, independent media can help in this direction. Public debate about development and its policies, and engendering national consensus about priorities are important to the process. So too are certain technical capacities – donors can support the legal, accounting and auditing professions, which are often weak. Greater transparency in aid procedures on the donors' part and their opening to public scrutiny would also be helpful.

- *Assist domestic capacity building.* Aid can help in training key decision makers as well as independent academics and researchers who can ensure a continuing personal and intellectual interchange on policy and public matters. The "brain-drain" of capable people from developing countries is not by any means solely due to the attraction of higher pay abroad. Many migrants would rather stay at home if they could make a contribution to national development – but that often requires that they be free to criticise as well as co-operate, without risk to their livelihoods.

The most difficult questions surround the issue of political conditionality. While democratic institutions can be valuable for building support for the "developmental state", and safeguarding civil institutions which promote transparency and accountability,[62] the experience of political conditionality has been mixed. It can backfire, and stiffen internal resistance to democratisation; or democratic institutions can be set up, and abused by demagogic politicians. It can also be positive – there have certainly been cases where threats to withdraw aid have assisted the move to helpful political reforms.

Donors are most likely to trespass onto unsafe ground if they try to specify the *form* of democratisation they favour; they are least open to criticism when they press for support for the institutions of civil society. In between these ends of the spectrum, donors have to exercise the most sophisticated judgment.

Discussion of these questions often transfers to that of "*need versus performance*" in aid allocation. Should donors give aid to those who need it most, or to those who make the best use of it? It is an old debate, but perhaps it sets the frame in the wrong place. There is not much point in giving aid where it will not be effectively used; and countries which make the best use of aid may be the ones who least need it. Surely the way through this maze is to apply criteria of both need and performance productively. Where governmental performance is poor while need is great, aid should be concentrated on improving that performance, and otherwise devoted to channels that depend less on government – NGOs and the private sector.

Performance can also be rewarded: and perhaps better retrospectively than prospectively. Many performance conditions are attached to loans already, but donors often find it difficult to curtail lending when the conditions are not fulfilled. They are involved in a complex relationship, and have to make fine judgments about whether on balance it is better to persevere with it or not. While these kinds of conditionality are inevitable – though it has been argued above that they would be more successful if they had more recipient support – donors might find it more effective to let recipients know that their progress is being monitored, and that signs of continuing good performance in specified respects (macro management, particular programmes) will be rewarded by future allocations, or poor performance (such as excessive pipelines of unspent aid) penalised.[63]

Strengthening the private sector

Many of the above functions of aid are important to the development of private activity, which must be one of the mainsprings of growth. Most donor countries have agencies supported by aid ministries which assist the private sector directly – the UK's Commonwealth Development Corporation (CDC) and its opposite numbers. Some of these agencies – not least those of Canada and the Nordic countries – have had valuable experience in aiding SMEs. Their experience could be more widely shared among themselves and with recipients. One of the keys to helping SMEs is finding the appropriate financial intermediary. But as noted earlier, funding is not the only problem: providing technical support may be at least equally important, and here East Asian, and perhaps particularly Taiwanese, rather than donor experience may be the most valuable.

While things have improved somewhat in donor sharing of the lessons of aid, not least because of efforts of the DAC, it is still true that donor agencies are more efficient in using the feedback from their own activities than from each other's. Donors have also had very mixed experiences with financing recipient development banks or Development Finance Corporations (DFCs) which on-lend to the private sector – often because they have neither been good at project selection nor "tough" in applying commercial criteria for lending; often too, not uncommon as the background to the last point, DFCs have been under political rather than strictly economic direction.

These are among the old instruments for private sector support. There are others. Public sector infrastructure and other projects and programmes can support the private sector. USAID successfully used a large road project in Thailand to foster the coming into being of a private sector construction industry by insisting that roads should not be built by the Public Works Department, but tendered for privately. Given that much aid will still flow to the public sector, this type of example can be more widely followed, including, as was noted above, some parts of health and education services.

The newer instruments include measures such as the Commonwealth Private Investment Initiative (CPII), under which the CDC as the manager of the CPII will invest in expanding privatised or privatising companies and SMEs across all sectors, emphasising the creation of new assets and the introduction of improved technology. New means have also to be found to combat what is proving to be a growing problem in several privatisation programmes, namely political objection to the character of the new ownership, be it foreign, or a domestic minority or other group. Countries are experimenting with unit trusts and other methods of creating ownership structures which permit wider participation in share-holding.

A valuable new study by the Overseas Development Council (Washington DC) of potential expanded roles for the World Bank in private sector support recommends four major new initiatives:[64]

- *A new operating unit within the International Finance Corporation (IFC) for project development promotion.* This should have the task of "project development promotion and investment in countries less advanced in private sector development that do not have market access to private financing". This would be a more entrepreneurial function than the IFC has mostly been used to, and would have to include the cultivation of entrepreneurship and management in the host country. It would take the IFC into countries that it has largely neglected, or felt obliged to neglect, and bring much-needed private investment to them.
- *A heightened role for the IFC as the private sector partner for the World Bank group.* The study argues that private sector knowledge and experience, and understanding of private sector activities in borrowing countries, is very thin within the Bank except in the IFC. The whole of Bank/IDA operations need to be more pervasively suffused with this knowledge and experience; a variety of managerial and organisational options are discussed for the purpose.
- *An expanded programme of intermediary financing.* This is not a return to the old DFCs, but an initiative to support the development of financial intermediaries, with capacities for project analysis and promotion, for on-lending, and for encouraging equity participation in the underlying investment projects. As the study argues, financial development is a slow process, especially in the less advanced countries; this kind of support for financial

intermediation should be part of the process, and will accelerate one of the main purposes of financial reform.

- *"Mainstreaming of guarantees"*. This has been the subject of a Bank paper, elaborated by the study. The proposal is to extend the Bank's guarantee capacity to portfolio investors and banks for public sector infrastructure financing, principally through the Multilateral Investment Guarantee Agency (MIGA), including partial guarantees, or performance guarantees (such as guarantees against breach of contract). Borrowing governments would make reciprocal guarantees of their contractual obligations. The essential aim of the initiative is to widen the range of countries given access to guarantee facilities.

The study emphasises that these initiatives, in the case of the first three, have implications for the staffing and "culture" of the Bank and IFC, and in the case of the second, to its operating principles. As with most fields of aid, improving support for the private sector is the subject of a wealth of writing and research – the main need is to bring this knowledge together and have it acted on. But the above four proposals are relatively new and creative, and deserve consideration.

A last word

Ultimately the aim of aid must be to become unnecessary. As more and more countries acquire the capacity to achieve their development without concessional borrowing, aid can concentrate on the remaining countries with the most difficult problems. For developing countries, the chief implication of limited aid is that they will have to do better themselves. Aid is of course not the most important external factor, and developing countries look to the industrial world for better trade and financial conditions in addition to aid. But if aid shortages concentrate both donors' and recipients' thinking on how to strengthen indigenous capacities for development, that would not be such a bad outcome.