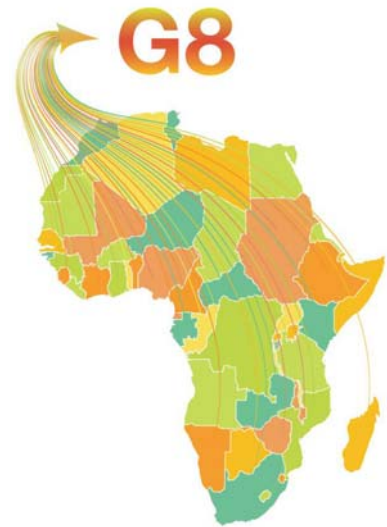


Africa after the Africa Commission: What Priorities for the German G8?



Working Group Report

Aid effectiveness and absorptive capacity: Which way aid reform and accountability?

Paolo de Renzio

Paolo began by contrasting two quotations from Kofi Annan, an aid advocate, and Bill Easterly, an aid sceptic. Last month, Annan said *'The commitment is that by 2010 there will be an additional \$25 billion dollars for development assistance. In 2005 we did very well. In 2006 we are sliding a bit, and unless we step up and make available about \$5 billion dollars a year moving forward, we will not meet that target. [...] The global economy is growing and we should seize this unique opportunity to try and push forward our efforts to get Africa on the right track.'* On the other hand, at the end of last year, Easterly claimed *'The theory that the end of poverty will be achieved by an aid-financed big push has been around since the 1940s; its repeated failure has led most students of this history to abandon it.'* Who is nearer the mark?

Paolo presented figures to answer the question 'is scaling up really happening?' Figures from the DAC show an overall fall in aid levels in 2006 compared to 2005, although aid to Sub-Saharan Africa (excluding debt relief to Nigeria) has risen slightly. He argued that a number of G8 members have been unable to convince domestic constituencies that fulfilling the 2005 commitment to double aid is a priority.

He went on to ask why scaling up is not happening and proposed two reasons: concerns about absorptive capacity and worries about governance in aid recipient countries. He said there are four elements to arguments about absorptive capacity:

- Concerns of donors about macroeconomic management of aid flows in recipient countries;
- Government capacity to use resources effectively;
- The impact of aid on domestic institutions. Would scaling up undermine government accountability to domestic constituencies?
- Donors behaving in a fragmented way, for example, not providing predictable flows of aid.

On governance, three factors are key:

- Worries about poor governance are making donors uncomfortable;
- The examples of Ethiopia and Uganda have seriously undermined donors' approaches to aid and 'good governance';
- The African Peer Review Mechanism is making slow progress.

Paolo went on to pose the question 'how can we arrive at recommendations for the G8?' and set out the four 'aid narratives' that exist at the moment. He contrasted the views of Jeffrey Sachs, Bill Easterly, Hilary Benn and George W. Bush. Sachs argues for an

externally driven 'big push' using initiatives such as the Millennium Villages project and technical assistance. By contrast, Bill Easterly argues for 'letting things happen', minimal external resources and building on what works in countries. Hilary Benn would like to see a 'big push' but based on internally driven processes, with donors working with country systems and strengthening domestic institutions. Bush wants initiatives like the Millennium Challenge Corporation to channel funds to countries but then allowing things to happen without a donor 'push'.

Paolo said that he stands somewhere between Benn and Easterly and agrees with their common focus on internally driven processes and providing the right incentives for local institutions.

He went on to discuss the tensions that surface in aid accountability. He argued there are two critical questions: accountability to whom and accountability for what. Donors are accountable domestically but there is a growing recognition that they need to be accountable to recipients. As for what aid is trying to achieve, there is tension between focusing on development outcomes (via MDGs, vertical funds) and on long-term institution building. If the focus is the former, what do we do after 2015 when the MDGs are supposed to have been reached?

He concluded with questions for discussion:

1. There are important knowledge gaps that need to be addressed. We know more on the macroeconomic side of aid and on aid fragmentation but we need to know more about sector specific bottle necks and long term institution building.
2. Aid modalities (and therefore aid quality) are at least as important as aid quantity in determining aid's impact
3. (Additional) aid should focus on strengthening (or at least not undermining) country systems and institutions
4. The predictability and pace of scaling up are at least as important as the availability of additional aid flows
5. Can multilateralisation address accountability tensions?
6. How can we keep the public on board?

Christopher Adam

Christopher began by stating that the issues around the macroeconomics of scaling up aid flows are well known and articulated in the Commission for Africa Report. There have been several conferences held and papers and policy briefings published.

He said the issue of aid absorption is serious but it is not a 'show stopper'. However, he argued, donor anxiety about absorption is pervasive and has contributed, in part, to the slower than expected increase in aid since 2005. This reflects a general expression of concern about giving aid; not necessarily about this specific macroeconomic issue. Nevertheless, he said we are at a point where we know what the main challenges are and what to do about them. Responses do need to be country-specific but some general lessons can be learned.

He recapped the central issue: that ideally aid will be spent *and* absorbed as this is the developmental rationale for providing it. He said the question is 'how much and how quickly'? If flows are too large or too rapid, quality of spending may decline, the distortionary effects of aid flows are magnified (e.g. 'Dutch disease'/competitiveness problems) and fragile governance structures may be put in jeopardy.

He argued that the macroeconomic objective of aid is to maintain medium term stability. Most actors agree with this aim, not just the IMF. In practice, this entails identifying a rate (and form) of spending that maximizes the developmental impact of spending but entails a

path for absorption which is credible in its respect for medium-term fiscal sustainability, does not jeopardize short-run macroeconomic stability and strikes a balance between public and private sector activities.

Christopher went on to identify 4 lessons:

1. There are no general prescriptions.
The severity and nature of absorptive capacity constraints, and hence capacity to scale up aid, are very country specific. They depend on structural characteristics (markets), initial macroeconomic conditions, governance and implementation capacity, and the composition and volatility of aid flows.
2. All macroeconomics is micro.
Key factors are labour market constraints, credit markets, tax structures, domestic resource mobilization, and coherent fiscal and monetary policy coordination especially when aid flows are volatile.
3. Credible commitments are important.
Two factors are involved: donors are unable to credibly pre-commit to long-term funding and recipients are unable to credibly commit to adjust spending to fluctuations in external finance. This raises the risk of the private sector seeing *expected* future financing gaps and holding off from investing.
4. Learn from commodity booms.
Aid increases have been overtaken by the scale of primary commodity booms. A key question is what we can learn from the management of resource booms. A key difference between commodity booms and high aid flows is that commodity booms occur independently of governance and capacity whereas increasing aid flows occur in a context of peer review and dialogue which could help management. The case of Chile provides valuable lessons on the economic issues of managing resource booms (in this case high copper prices).

Christopher concluded with the policy implications for donors. He recommended that donors:

- Make longer, more credible and more stable commitments;
- Support greater flexibility in macroeconomic management of aid flows;
- Engage with international finance institutions on development of coherent macroeconomic strategies for scaling up;
- Learn from the evidence on commodity price booms.

The presentations were followed by a wide ranging discussion which was synthesized into 4 key messages to the G8.

Discussion

The following points and comments were made:

- The events in Ethiopia and Uganda in 2006. It was argued that it is a myth that these countries were *ever* models of good governance. They were presented this way to justify the way aid was given. Only the donors were surprised when governance 'went wrong'.
- The need for donors to take responsibility for monitoring the impact of new aid modalities on civil society.
- The need to be realistic about pushing for better aid. Data collection and research takes time.
- Recent focus groups in the UK have suggested that the UK electorate prefers the Government to provide project based aid not General Budget Support.
- The focus on aid management needs to shift from a donor perspective about aid management to a recipient perspective about public financial management.
- The G8 should not keep shifting its attention to new issues as they come up; continuity is important when trying to solve problems.

- Strategies need to be identified at country level.
- Project based direct investment has more impact than General Budget Support.
- Aid should not be earmarked, or, if it is, it should be earmarked for large infrastructure.
- Aid recipient governments are accountable to donor governments rather than their domestic electorate.
- Why not give direct grants to individual households?
- It is crucial to build public debate about aid in recipient countries and the media has an important role. Working with parliamentary systems is key.
- How useful are the MDGs? Do they distort accountability and spending? The G8 should work to make MDGs part of the solution.
- The current debate about aid is too apolitical. The 'War on Terror' will have huge implications on development in the Horn of Africa and is distorting aid. The G8 should look at the military budgets of the poorest countries.
- How can the public debate become more informed and more plural? How can more people in recipient countries critique the situation.
- The G8 need to manage expectations about what can be achieved with aid.
- How much of the current high level of African growth is simply due to high commodity prices? Should aid in fact be given counter-cyclically to commodity-deficit countries suffering from high prices?
- Community level partnerships between Wales and Uganda are proving successful and involving a wider range of people in the aid debate.
- Budget support needs to be long-term and engage with governments.

Key messages to the G8

- Provide more credible, longer term commitments.
- Deliver aid through modalities that strengthen domestic institutions and accountability.
- Recognise the governance challenges African countries face and support domestic accountability actors.
- Manage expectations in donor countries about what aid realistically achieve.