Foreign aid as a constraint on developmental public policy in low-income countries: examples from Sub-Saharan Africa

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Abstract
The paper addresses the causal links between public policy and development, with a focus on the negative impacts of aid dependence in low-income countries and the subsequent problems of policy credibility. In a perspective that borrows from the disciplines of political economy of development and economics, and using evidence from Sub-Saharan Africa, the paper deepens concepts such as dependence, externalisation and asymmetry (in the relationships between the ‘donors’ and recipient governments). It underscores a series of consequences: i) the possible formation of ‘aid traps’ and self-reinforcing vicious circles, where aid dependence perpetuates both economic stagnation and the continuation of aid, although aid is supposed to have its own end as a primary goal; ii) the weakening of a core foundation of the state-citizens social contract and government legitimacy, i.e. the links between taxation, spending and redistribution - as aid dependence breaks these links and makes governments accountable to external agencies; iii) the erosion of the credibility of domestic public policies - citizens perceiving them as being elaborated outside the country. Therefore, even if these public policies were ex ante developmental, a consequence is the ex post erosion of their effectiveness and hence the perpetuation of status quo and economic stagnation.

1. Introduction
The paper addresses the causal links between public policy and development, with a focus on the negative impacts of aid dependence in low-income countries and the
subsequent problems of policy credibility\textsuperscript{1}. In a theoretical perspective that borrows from the disciplines of political economy of development and economics, and using evidence from Sub-Saharan Africa’s low-income countries, the paper deepens concepts such as dependence, externalisation and asymmetry in the relationships between the ‘donors’ and recipient governments, notably regarding policy financing and conceptual paradigms.

It underscores a series of consequences of foreign aid and aid dependence in particular, where economic and political economy levels cannot be dissociated:

i) the possible formation of ‘aid traps’ and self-reinforcing vicious circles, where aid dependence perpetuates both economic stagnation and the continuation of aid, although aid is supposed to have its own end as a primary goal;

ii) the weakening of a core foundation of the state-citizens social contract, i.e. the links between taxation, spending and redistribution - government’s institutions being legitimate agents of taxation, beneficiaries of public spending and vectors of social redistribution with effective capacities -, as aid dependence breaks these links and makes governments accountable to external agencies;

iii) the erosion of the credibility of domestic public policies (and administrations): citizens may perceive them as lacking a key dimension of credibility - i.e. independence and ability to (autonomously) commit -, being elaborated outside the country, ignoring its historical specificities, stemming from rationales that are internal to foreign agencies (e.g., enhancing the recipient government’s ability to meet its international financial liabilities and foreign investment via exports and trade openness; applying conditionalities and sanctions according to donors’ governments foreign policy); therefore, even if these public policies were \textit{ex ante} developmental, a consequence is the \textit{ex post} erosion of their effectiveness and hence the perpetuation of status quo and economic stagnation.

The paper is structured as follows. It firstly underscores the ambiguous character of the concept of foreign aid. Secondly, it presents the evolution of aid in Sub-Saharan Africa. Thirdly, it analyses the detrimental effects of aid dependence. Finally, it highlights the negative impacts of aid dependence on state capacity and the credibility of public policies, which ensue from the intrinsic asymmetry of the aid game.

\section*{2. Aid: an ambiguous concept}

Aid or Official Development Assistance (ODA) is a complex concept\textsuperscript{2}. Such a complexity warns about the possible weakness of results from econometric modelling that rely on broad variables such as ‘aid’ and of the conclusions drawn from them. The main donors are members of the OECD DAC, which include 24 members (most

\begin{footnotesize}
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\textsuperscript{1} Sindzingre (2012) analyses the paradoxes of aid, and provides elements for this paper.
\textsuperscript{2} The main source is the OECD Development Assistance Committee (DAC) and its annual Development Cooperation Reports. The DAC works with the OECD Development Cooperation Directorate: see the DCD-DAC website: \url{http://www.oecd.org/department/0,2688,en_2649_33721_1_1_1_1_1,00.html}. The AidData project is also a key source regarding global aid flows and projects: \url{http://www.aiddata.org/home/index}.
\end{footnotesize}
European states, Japan, the US, Australia, New Zealand, Switzerland...). The World Bank, IMF and UNDP participate as observers.

There are various sources of aid: multilateral agencies - e.g. the international financial institutions (IFIs, the IMF and the World Bank) or regional institutions, such as the European Union (EU), the African Development Bank, the Asian Development Bank, and many others -, and bilateral sources. A substantial part of aid to a region such as Africa, which is characterised by a great number of low-income and aid dependent countries, is thus channelled through multilateral agencies.

**Definitions matter**

Aid is an element of global development finance, which can be private (e.g., remittances, foreign direct investment, portfolio equity, private debt and private grants) or official. Official development finance includes: 1) Official Development Assistance (ODA) (i.e. grants and concessional loans); 2) Other Official Flows (OOF), i.e. export credits (concessional or market-rate) and other OOF (Brautigam, 2010). For the DAC, ‘aid’ and ‘assistance’ refer only to flows which qualify as ODA.

It is often thought that aid is meant to provide assistance to the needy, that it is driven by altruistic and humanitarian motives, and that for these reasons it is mostly made of gifts, which would be logical. ODA includes grants, but also some proportion of loans, however. This implies that aid recipient countries must reimburse some part of this assistance, even if the loan share of total ODA is low for most bilateral donors – but higher for multilateral and regional agencies -, and even if these loans must be concessional, i.e. including a ‘grant element’ of at least 25%.

Aid is indeed defined by the proportion of the ‘grant element’ that the financial flow includes. The grant element reflects the financial terms of a transaction: interest rate, maturity and grace period. In many donor countries, the share of grants in bilateral ODA is close to 100%. The grant element of aid to Least Developed Countries (LDCs) by DAC members is close to 100% (OECD-DAC report 2011, table 20). Similarly, the World Bank has a concessional fund for low-income countries, the International Development Association (IDA).

**Table 1: Loan share of total ODA, DAC members, 2010 (%)**

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<th>Germany</th>
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Source: OECD-DAC, Statistics on Resource Flows to Developing Countries, table 22. [http://www.oecd.org/document/9/0,3746,en_2649_34447_1893129_1_1_1_1,00.html](http://www.oecd.org/document/9/0,3746,en_2649_34447_1893129_1_1_1_1,00.html)

3 According to the annual OECD DAC Development Cooperation Reports: all definitions can be found in the ‘Glossary’ included in the DAC annual reports: [http://www.oecd.org/document/24/0,3746,en_2649_34447_48745304_1_1_1_1,00.html](http://www.oecd.org/document/24/0,3746,en_2649_34447_48745304_1_1_1_1,00.html). See also: [http://www.oecd.org/document/32/0,3343,en_2649_33721_42632800_1_1_1_1,00.html](http://www.oecd.org/document/32/0,3343,en_2649_33721_42632800_1_1_1_1,00.html)
Official development assistance is given to specific recipient countries that exhibit all ranges of income levels - the DAC ‘List of ODA Recipients’, which it revises every three years: the LDCs (Least Developed Countries); Other LICs (Low-Income Countries), which include all non-LDC countries with per capita GNI 1005$ or less in 2010; LMICs (Lower Middle-Income Countries), i.e. with GNI per capita between 1006$ and 3975$ in 2010; and UMICs (Upper Middle-Income Countries), i.e. with GNI per capita between 3976$ and 12275$ in 2010.

**The variety in types of aid**

There are many different types of aid, with different terms and conditions. For example, aid may be tied or untied. Tied aid conditions financial flows to the purchase of equipment or a technical assistance from the donor country. Most aid to the LDCs, however, is now untied and some donors have untied all their aid. Likewise, ODA can be made of project assistance or programme assistance. The former has been subject to criticism in the mid-1990s as one of the examples of the disappointing outcomes of aid. The focus has shifted to programme assistance that would not be ex ante earmarked to specific projects – recipient governments’ budget support being an example\(^4\), which is an illustration, among many others, of the variation of the paradigms and conceptual frameworks that have shaped aid over decades.

This shift was associated with another important debate that started in the 2000s within the IFIs, that of the failures of the traditional conditionalities that are linked to aid\(^5\). This has generated another paradigm change in the 2000s, that of the advantages of aid ‘ownership’ – which has underlain the shift of the IFIs from the stabilisation and adjustment programmes of the 1980s to the Poverty Reduction Strategy Papers (PRSPs) - and that of the advantages of *ex post* conditionality and assessments of aid results, vs. the traditional *ex ante* conditions.

Official Development Assistance comprises heterogeneous elements, which may appear far from the common intuition of aid with its connotation of help or assistance. Bilateral aid, for example, includes technical cooperation, food aid, emergency and distress relief, debt forgiveness and administrative costs, bilateral loans, and bilateral contributions to multilateral institutions.

As highlighted by Sundberg and Gelb (2006), in contrast with what public opinions would expect - and the DAC definition - a large amount of aid is not intended for development: it includes ‘special-purpose’ items such as programme administration, emergency and food assistance, technical cooperation and debt relief. It is the ‘non-special-purpose’ grants that constitute what taxpayers typically consider foreign aid: education, infrastructure, health projects and budget support. Sundberg and Gelb underscore that this share of aid going to development projects and programme support has declined during the 1990s due to increases in administrative costs, debt relief and emergency aid, and that technical cooperation has historically been the second largest

\(^4\) The policy literature is huge: evaluation have been made, among many others, by the OECD in 2006: [http://www.oecd.org/document/51/0,3746,en_21571361_34047972_36556979_1_1_1_1_1_1,00.html](http://www.oecd.org/document/51/0,3746,en_21571361_34047972_36556979_1_1_1_1_1_1,00.html); the Overseas Development Institute (ODI): [http://blogs.odi.org.uk/blogs/main/archive/2006/07/26/624.aspx](http://blogs.odi.org.uk/blogs/main/archive/2006/07/26/624.aspx); [http://www.odi.org.uk/work/projects/details.asp?id=1013&title=sector-budget-support](http://www.odi.org.uk/work/projects/details.asp?id=1013&title=sector-budget-support); the World Bank (Koeberle *et al.*, 2006).

\(^5\) The academic and policy literature is very vast: see for example IMF (2005; 2008).
component of aid, though experts often come from donor countries and financial flows remain in these donor countries. Administrative costs on bilateral aid have increased in the 2000s to nearly 8% of assistance, due in particular to the proliferation of agencies and donor countries, in addition to the huge administrative burden that aid impose on recipient countries’ civil services. Equally, debt relief has increased during the 2000s to some 20% of ODA: as noted by Sundberg and Gelb, however, debt relief does not provide new resources for development. Emergency and food aid have also increased in the 2000s, and similarly their contribution to long-term development is limited.

3. The evolution of aid flows

Global aid flows

Aid has been a major source of external finance in low-income countries since the 1970s. Comparing 1991-95 with 1970-75, for low-income countries on average, aid as a share of GDP increased from 6 to almost 15%, while private capital inflows (including FDI) fell from 2 to 1% of GDP (Morrissey, 2004).

From 1960 to 1990, ODA flows from DAC countries to developing countries rose steadily. Total ODA as a percentage of DAC countries' combined Gross National Income (GNI), however, fell between 1960 and 1970, and then oscillated between 0.27% and 0.36% for about 20 years. Between 1993 and 1997, ODA flows fell by 16% in real terms due to fiscal consolidation in donor countries after the recession of the early 1990s. Aid then started to rise in real terms in 1998, but was still at its historic low as a share of GNI (0.22%) in 2001. ODA flows then increased and in 2005, donors made further commitments to increase their aid at the Gleneagles G8 and UN Millennium +5 summits. In 2005 and 2006, aid peaked due to exceptional debt relief for Iraq and Nigeria. Until 2010, ODA flows have continued to rise despite the 2008-09 global financial crisis. Aid fell by 3% in 2011, however, due to the global recession.

Figure 1: DAC members’ total net resource flows to developing countries (1970-2009)


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6 OECD-DAC http://www.oecd.org/document/41/0,3746,en_2649_34447_46195625_1_1_1_1,00.html
7 http://www.oecd.org/document/3/0,3746,en_2649_37413_50058883_1_1_1_37413.00.html
The figure below shows the ups and downs of aid over the last 50 years.

**Figure 2: Net official development assistance over 50 years (1960-2010)**

![Graph showing net official development assistance over 50 years](Image)


As shown by the figure below, a substantial share of ODA goes to Africa.

**Figure 3: Net Official Development Assistance, 1990-2010, including to Africa**

![Graph showing net official development assistance, 1990-2010](Image)


Official aid flows exhibit significant variations. In the 1990s, aid flows were diverted to transition economies and driven by particular events, e.g. debt relief. Multilateral agencies represent a growing share of total aid.

**Figure 4: Components of DAC donors’ ODA**

![Graph showing components of DAC donors’ ODA](Image)

There are sharp differences among donors and over time.

Figure 5: Net official development assistance in 2011 (% of GNI)


The uses of ODA have evolved over time, with, in line with the paradigm of poverty reduction and capacity building of the 2000s, a shift to social and administrative infrastructure.

The evolution of aid to Sub-Saharan Africa

The largest share of ODA goes to two regions, Africa and Asia. As highlighted by Easterly (2009), over the last five decades, Sub-Saharan Africa (SSA) stands as the most aided region. Aid has been a key source of financing in SSA since the 1960s.

Figure 6: Regional shares of total net ODA, as a percentage of total ODA

According to the OECD-DAC\(^8\), over 2008-10 on average, the main donors to Africa by amount were the United States, then the EU, then the World Bank (IDA), then France, the United Kingdom, then other donors. Indeed, a characteristic of Sub-Saharan Africa is that multilateral donors play a key role, in particular the EU.

**Figure 7: Net disbursements of official development assistance to Africa by donors**

(current USD million)

![Graph showing net disbursements of official development assistance to Africa by donors](source)


Aid to Sub-Saharan Africa has been strongly influenced by the paradigm of poverty reduction that is dominant since the 2000s across all multilateral and bilateral donors, which has been driven by the World Bank and some bilateral countries such as the Scandinavian countries and the United Kingdom (Sindzingre, 2004; 2008). Aid increasingly goes to social sectors.

**Figure 8: ODA to Africa by sector since 1990** (percentage of total ODA to Africa, 3-year average commitments)

![Graph showing ODA to Africa by sector since 1990](source)


The emergence of new donors, in particular China

The international aid landscape is now characterised by the emergence of ‘non-traditional’ donors, i.e. not members of the DAC - global funds, private foundations and firms, NGOs, bilateral donors (e.g., Brazil, China, India,..) (Ahmed, 2008). This contributes to the proliferation of donors that simultaneously have smaller shares of total aid. China has become a central donor (Nissanke and Söderberg, 2011), although Chinese aid is not a recent phenomenon (e.g., to SSA).

In Africa in particular, China uses original contractual relationships that mix aid, foreign direct investment and trade (Christensen, 2010; Sindzingre, 2011), coined as the ‘Angola model’ (Davies, 2010; Corkin, 2011). SSA countries barter natural resource exports for investment in infrastructure by Chinese firms: China here bundles ODA-type aid with commercial trade finance in a single transaction; the money from China’s Eximbank does not pass through the host country government and goes directly to the Chinese contractor (Orr and Kennedy, 2008). Brautigam (2009; 2010)\(^9\) shows that China Eximbank export credits are far larger than aid and that the objectives of Chinese aid are firstly the promotion of Chinese business. Chinese aid does include elements that are not viewed as aid by DAC definitions, such as subsidising infrastructure, direct finance to Chinese companies and resource-backed infrastructure loans.

4. The detrimental consequences of aid dependence

A positive impact of aid on the growth of recipient countries? Growing controversies

Why aid other countries? A primary justification is that ODA is beneficial to the aided country, and at least enhances its growth rates and its level of income. Since the mid-20\(^{th}\) century the understanding of aid is based on economic theories, which find a positive relationship between aid and recipient countries’ growth (Hansen and Tarp, 2000; Tarp, 2006; Arndt et al., 2009) and are based on a variety of models - the Harrod (1939)-Domar (1946) model, further developed by the Chenery and Strout (1966) ‘two-gaps’ model (Easterly, 1999), later marginalised by the neoclassical growth model and by endogenous growth theory, which consider that physical capital investment is a less important determinant of growth than education and research (White, 1992; 1998). Investment is a key channel of transmission in the relationship between aid and growth (Gomanee et al. 2005). There are debates on this channel, however, given the weak relationship between aid and growth in some regions – indeed, ODA may take the form of net acquisition of foreign assets by the private sector (capital flight) or by the public sector (reserve accumulation) (Serieux, 2009).

These different channels and impacts, however, are subject to important controversies, in particular on ‘aid effectiveness’ (Temple, 2010; Doucouliagos and Paldam, 2009; Nissanke, 2010), while, interestingly, donors’ agencies at the same time have augmented their aid and promises of increases in aid.

\(^9\) See also her blog: [http://www.chinaafricarealstory.com/](http://www.chinaafricarealstory.com/)
These tensions have been highlighted by Easterly (2009), who distinguishes the predominant ‘transformational’ approach (“the West saves developing countries”) from a more ‘marginal’ approach (“the West takes one small step at a time to help individuals in poor countries”). He shows that two themes underlie donors attitudes: “escalation”, i.e. “as each successive Western transformational effort has yielded disappointing results, the response is to try an even more ambitious effort”; and “the cycle of ideas”, i.e. rather than a discarding of failed ideas, these ideas come back again when the previous disappointing experience is forgotten. Both attitudes, however, have in common the lack of learning that is characteristic of the ‘transformational’ approach.

Easterly (2001) has thus argued that 1000 billion$ have been spent by bilateral donors and the IFIs since the 1960s, but that the outcome has been a failure and with aid being driven by ‘fads’, such as “independent judiciaries”, “decentralisation” and the like. He notes that in the 1980s and 1990s, the IFIs made 958 conditional loans; during the 1990s, they gave 10 or more conditional loans each to 36 poor countries, “even if government mismanagement continued”: but the growth rate of income per person of the typical member of this group during the 1980s-90s was zero. The conditions on the loans were not enforced, and multilateral and bilateral agencies are responsible: they had incentives to continue lending even when recipient governments do not implement policies, because the function of agencies is to give aid and loans. The conditional debt forgiveness packages of the 2000s demonstrated that the previous conditional loans had not worked, but donors have an interest in “overselling solutions”, such as “accountability”, ‘political stability’ and so on.

Easterly develops these arguments in other studies, e.g., Easterly (2006), who highlights the misuse of aid funds and corruption, and Easterly (2007a), who calculates that over the past 42 years, 568 billion$ (in 2007 dollars) has flowed into Africa, while the per capita growth of the median African country has been close to zero: the top quarter of aid recipients (most being in Africa) received 17% of their GDP in aid over those 42 years, yet they had near-zero per capita growth. Moreover, there are no examples of development due to a large inflow of aid and technical assistance: South Korea, for example, took off after aid was reduced, and did not follow donors’ policy advice. For Easterly (2003a), the literature lacks a theoretical model by which aid would influence growth, and there is no relationship between aid and growth.

Figure 9: Aid and growth in Africa (10-year moving averages)


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10 See Easterly blog, Aid Watch: http://aidwatchers.com
Against such arguments, poor effectiveness of aid is explained by a variety of arguments, for example by problems of causality and the difficulty of attribution of effects – to aid or other causes (Bourguignon and Sundberg, 2007). In addition, the relationship aid-growth is contingent on several factors other than recipient country’s policies, e.g. political conditions (Chauvet and Guillaumont, 2002).

The IFIs use other arguments. For the World Bank, aid is effective in promoting growth, and the culprits are the recipient governments that resisted reforms (Dollar et al., 2001). Due to the fungibility of aid, aid is an incentive for recipient governments to reduce their tax efforts. For the World Bank, aid is effective in the presence of “good policies” (Burnside and Dollar, 1997; Dollar and Pritchett, 1998) – ‘good’ fiscal, monetary and trade policies, ‘sound institutional and policy environments’, ‘good governance’ (Burnside and Dollar, 2004; Dollar and Levin, 2004), and in the presence of ‘poor policies’, aid has no positive effect on growth. The notion of ‘aid selectivity’ thus became influential in the 2000s: aid must be given to governments which ‘merit’ aid and implement “good policies” (Collier and Dollar, 2002). This approach of aid is prescriptive: countries with “unsound policies” should receive less aid, as they lessen aid’s impact on growth.

These studies have triggered heated debates, e.g., as to whether the effectiveness of aid inflows depends on the policy regime of recipient countries (McGillivray et al., 2005), and have been subject to many criticisms (Roodman, 2003/2007; Easterly et al., 2003; Antipin and Mavrotas, 2006; Roodman, 2007; 2008). In fact, the aid-growth relationship may be non-linear (Lensink and White, 2001): benefits of aid may increase with the initial inflows, but decline after a certain level. There may be threshold effects, diminishing returns of aid, and aid effectiveness may be greater at lower levels of development (a views refuted by Kourtellos et al., 2007).

Interestingly, the IMF has also questioned the positive character of the relationship aid-growth. Rajan and Subramanian (2005a) show that there is little robust evidence of a positive (or negative) relationship between aid inflows into a country and its growth, and no evidence that aid works better in better policy environments, or that certain forms of aid work better than others: aid may lead to the mismanagement of the real exchange rate, which affects the manufacturing sector. Similarly, Rajan and Subramanian (2005b; 2009) show that aid inflows have systematic adverse effects on a country’s competitiveness, as reflected in a decline in the share of labour-intensive and tradable industries in the manufacturing sector, due to the real exchange rate appreciation caused by aid inflows.

The relationship aid-growth also depends on the type of aid. Clemens et al. (2004) distinguish 3 categories of aid: 1) emergency and humanitarian aid (likely to be negatively correlated with growth); 2) aid that affects growth over a long period of time, e.g. aid to democracy, the environment, health or education (likely to have no relationship to growth in the short-term); 3) aid that stimulates growth within a short-term time span, i.e. 4 years, such as budget and balance of payments support, investments in infrastructure, aid to productive sectors (agriculture, industry). Clemens et al. find a positive causal relationship between aid and growth for this third type of aid (but with diminishing returns). Grants or loans may also induce different degrees of effectiveness (Mourmouras and Mayer, 2004).
Aid dependence, ‘traps’ and the negative macroeconomic effects of aid volatility

An increasing number of studies since the 2000s highlight the negative effects of aid, especially in poor or aid-dependent countries: aid dependence may lead to vicious circles and ‘aid traps’. A key channel of these negative effects is aid volatility.

Some countries are excessively dependent on aid, e.g., for budgets, investment, maintenance, infrastructure, health and education. The key indicators of aid dependence are aid as a percentage of GNI; as a percentage of gross capital formation; as a percentage of imports of goods, services and income; and as a percentage of central government expenses.

Sub-Saharan Africa is characterised by high aid dependence. According to the World Bank World Development Indicators (2011), aid in SSA represented 20$ per capita in 2000 or 4.1% of Gross National Income (GNI); and 53$ per capita and 4.9% of GNI in 2009. In 2000, aid in SSA represented 23.1% of gross capital formation, and 25% in 2009. In 2000, aid in SSA represented 11% of imports of goods, services and income; in 2009, 12%. However, some countries exhibit low dependency ratios, e.g., Nigeria or South Africa, and SSA countries are not the worst cases - in Haiti, in 1997, aid represented 93.4% of central government expenditure; in Nicaragua in 2002, 84.9%....

The World Bank is aware of the negative effects of aid dependence, which impairs export competitiveness and export-oriented development strategies. Substantial aid inflows have effects that are similar to ‘Dutch disease’, notably the risk of appreciation of the real exchange rate (Li and Rowe, 2007; Killick and Foster, 2007; Elbadawi, 1999). The IMF is also aware of the problems caused by aid dependence, in particular Dutch disease: aid surges have negative effects on recipient countries’ fiscal management, budget discipline, savings and indebtedness (Aiyar et al., 2008; Berg and Zanna, 2010). Aid also creates incentives for capital flight.

An important channel of aid dependence’ negative effects is the volatility of aid: the analogy is often made with the detrimental impact of windfall gains that stem from commodity price volatility and therefore volatility of commodity-dependent countries’ export earnings, which are likely to create ‘Dutch disease’ effects. The negative effects of aid volatility have been highlighted by the IMF, especially the problems of managing uncertain flows, of the absorptive capacity of recipient countries, of macroeconomic fiscal management and government spending in recipient countries (Bulir and Hamann, 2001; Bulir and Lane, 2002). Aid flows are typically unpredictable and even more volatile than fiscal revenues, particularly in highly aid-dependent countries. This volatility increases with the degree of aid dependence as measured by the aid-to-revenue ratio. Uncertainty about aid disbursements is large and information content of donors’ commitments is very small: commitments by donors consistently exceed disbursements, and therefore aid cannot be predicted reliably on the basis of donors’ commitments alone (Bulir and Hamann, 2003). Using new data, Bulir and Hamann (2008) similarly find that the volatility of aid flows is still much greater than that of domestic revenue. Especially in poor, aid-dependent countries, this high volatility makes the macroeconomy difficult to manage. Moreover, aid is procyclical (not countercyclical): aid has failed to act either as a stabilising force or as an insurance mechanism.
Martins (2010) also finds that since the 1990s, for both low-income and middle-income countries, aid volatility has been an increasing problem, which is aggravated when aid is unpredictable - i.e. commitments are poor predictors of actual disbursements. He confirms the procyclical character of aid, i.e. that aid inflows tend to increase when a country’s growth is rising but decline when it is falling - the opposite of the optimal pattern. In SSA for example, during 1990-2005, on average, annual aid disbursements deviated from aid commitments by 3.4% of GDP. Countries cannot make full use of aid when it is unpredictable (Celasun and Walliser, 2008).

**Aid dependence and ‘aid traps’: the negative microeconomic effects of aid fragmentation and the weakening of state capacity**

The proliferation of aid agencies, projects and procedures is a key cause of the detrimental consequences of aid, notably on state capacity and ability to devise and implement developmental public policies. Intrinsic incoherence, important transaction costs and coordination failures stem from the multiplicity of donors, and these costs affect donors as well as recipients. In addition, donors have incomplete information about the other donors’ aid, and these information problems extend to the recipient countries, which are not aware of donor activities in detail *ex ante*, and even *ex post*.

The institutional complexity of the global governance of aid has spectacularly increased and reinforces the lack of coordination and predictability of aid. There has been a continuous increase of the number of donors: the average number of donors per country tripled over the last half century, rising from about 12 in the 1960s to about 33 in the 2001-2005 period, and the number of international organisations, funds and programs, about 230, is now higher than the number of developing countries they were created to assist (World Bank, 2007; Ahmed, 2008). This creates not only incoherence, but an inherent competition between donors. Another study counts about 280 bilateral donor agencies, 242 multilateral programmes, 24 development banks and about 40 UN agencies, which is compounded by an increasing number of private foundations, NGOs and projects – some 340000 projects around the world (Deutscher and Fyson, 2008).

In 2004, the 10 biggest donors - the US, Japan, IDA, EC, France, United Kingdom, Germany, Netherlands, Sweden and Canada - accounted for 79% of the total, while the 20 smallest agencies account for 6.5% of the total – the multiplication of many small players being understated because many bilateral donors have more than one agency (Easterly and Pfutze, 2008; Easterly, 2007b).

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**Figure 10: Share of gross ODA by donor, 2008**

Source: Easterly and Williamson (2011), based on data from OECD DAC.
The number of projects nearly tripled between 1995 and 2003 (Roodman, 2006b). Uganda has over 40 donors delivering aid, it had to deal with 684 different aid instruments and associated agreements between 2003/2004 and 2006/2007 for aid coming into the central budget alone. A 14-countries survey by the OECD and the World Bank showed an average of 200 donor missions per year, three-quarters of these by a small number of donors. Cambodia and Vietnam received 400 missions each, Nicaragua 289, Bolivia 270 and Bangladesh 250. There are 90 global health funds. St. Vincent, with a population of 117000, was asked to monitor 191 indicators and Guyana, 169 indicators, on HIV/AIDS (Killick, 2008).

Similarly, in Vietnam in 2002, there were 25 official bilateral donors, 19 official multilateral donors and 350 international NGOs, i.e. 8000 projects (Halonen-Akatwijuka, 2004). The health sector is an example of the proliferation of aid channels and aid fragmentation, with more than 100 organisations involved (World Bank, 2007). Tanzania is an example of transaction costs generated by aid, with 700 projects managed by 56 parallel implementation units, half of all technical assistance not being coordinated with the government and having received 541 donor missions during 2005, with 17% involving more than one donor.

Aid recipient countries are confronted with multiple donors’ requirements and administrative procedures that are not harmonised and create a heavy burden on implementation capacities and civil services - 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 (Sundberg and Gelb, 2006).

For Easterly, national and international aid bureaucracies are a failure because they measure output as money disbursed rather than service delivered, produce mostly reports with little ex-post evaluation, without any learning from the past and enormous demands on administrative skills, which are typically scarce in poor countries (Easterly, 2003b). The innumerable reports on ‘the need for aid’ firstly justify the existence of the international bureaucracy of aid agencies (Easterly, 2005). Aid agencies do not learn from experience and new knowledge. Donor fragmentation, unchanged emphasis on technical assistance and the lack of selectivity show the permanence of the status quo and repetition of past mistakes (Easterly, 2007b).
5. Aid as an asymmetric game and its negative impact on developmental public policies

Other crucial channels of the negative effects of aid dependence and the possible formation of ‘aid traps’ are the weakening of recipient governments’ capacities, institutions - notably fiscal institutions - and policies, and the inefficiencies generated by the intrinsic asymmetry of the aid game.

This asymmetry erodes the credibility of domestic public policies: foreign aid is associated with policy conditionalities, and therefore citizens may perceive the policies of their government as being elaborated outside the country and determined by rationales, which are first and foremost internal to foreign agencies and overlook the specific constraints of the recipient economy.

The negative impact of aid dependence on recipient countries’ institutions, taxation and the state-citizens social contract

Aid dependence undermine institutions, and in particular a core foundation of the state-citizens social contract and government legitimacy, i.e. the links between taxation, public spending and redistribution - government’s institutions being legitimate agents of taxation, beneficiaries of public spending and vectors of social redistribution: indeed, aid dependence breaks these links and makes recipient governments accountable to external donors, instead of citizens-taxpayers.

The IMF also underscores that aid may be associated with a weakening of recipient governments’ governance, because aid inflows reduce the need for governments to tax the governed: if aid reduces the efficiency of manufacturing investment by adversely affecting governance and thus contracting, then aid may reduce the profitability of investment and limit growth (Rajan and Subramanian, 2007).

Likewise, Moss et al. (2006) demonstrate the negative effects of aid dependence on state institutions, fiscal revenues and the relationship between state and citizens: states which can raise a substantial proportion of their revenues from aid are less accountable, under less pressure to maintain legitimacy, less likely to have the incentives to invest in effective public institutions. Aid undermines institutions and taxation capacity: it has a negative influence on incentives for institutional development and on the accountability of state institutions to their own populations (Moss and Subramanian, 2005).

Indeed, aid may typically be viewed as a rent (Auty, 2007). Like natural resource rents, aid is a revenue stream that is detached from the economic activity that generates it, which fosters political contests for its capture. For Auty, these contests create for the recipient government incentives to rent-channelling at the expense of development and wealth creation. Aid may also induce a brain drain of human capital, replaced by costly and often inefficient technical assistance.

Also, in many African low-income oil importers, domestic revenue mobilisation has not kept pace with rising public spending, and a growing share of current spending is therefore financed by aid: from 1997-99 to 2004-06, the share of current spending
financed by aid increased from 16% to 36% in Ghana, from 22% to 40% in Tanzania and from 60% to 70% in Uganda. Aid-financed projects give rise to additional spending (on operations and maintenance), which need to be covered from domestic resources: the country must generate sufficient revenue to finance these expenditures, or the productivity of aid-financed projects suffer (Gupta and Tareq, 2008).

Figure 12: Aid and tax revenues per capita in Africa in 2008


Political economy as a key dimension of aid

The impacts of aid are influenced by the characteristics of the aid ‘game’ itself, in particular the features of aid contracts - e.g., conditionalities -, donors’ political objectives and the political economy of recipient countries. Political economy is indeed an essential dimension of aid, and it explains many aid failures. Aid is not always going to the needy and most deserving countries, besides official targets of reducing poverty and requisites of ‘good governance’.

Aid is a dimension of foreign policy in all donor countries - major recipients of aid have been for the US Egypt, Israel, Pakistan, Iraq... for the UK, India... (Alesina and Dollar, 2000). For example, aid took a significant dip after the end of the Cold war (Sundberg and Gelb, 2006). Political motives obviously reduce the effectiveness of aid.

Political and foreign policy motives cannot be dissociated from economic motives: foreign aid is viewed in some studies as an industry benefiting donors – the ‘aid business’ -, which does not have development as an objective (Raffer and Singer, 1996). In this regard, aid has long been ‘tied’, which has been a clear motive of inefficiency. The situation, however, has improved after the 1980s (Easterly and Williamson, 2011).
In addition, despite donors’ official objectives of ‘good governance’, corrupt governments receive as much as the less corrupt (Alesina and Weder, 2002), and even more – around 80% of aid in the mid-2000s (Easterly and Williamson, 2011).

Similarly, despite donors’ official objectives and conditionalities regarding the improvement of ‘governance’ in recipient countries, aid does not go to the most accountable and democratic political regimes.

Table 2: Examples of aid going to autocracies; sum 2004-2008, billion $

<table>
<thead>
<tr>
<th>Donors</th>
<th>Recipients</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$46</td>
</tr>
<tr>
<td>Japan</td>
<td>$23</td>
</tr>
<tr>
<td>Germany</td>
<td>$16</td>
</tr>
<tr>
<td>World Bank (IDA)</td>
<td>$14</td>
</tr>
<tr>
<td>France</td>
<td>$14</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>$10</td>
</tr>
<tr>
<td>EC</td>
<td>$9</td>
</tr>
</tbody>
</table>

Political economy is one of the determinants of the lack of coordination and coherence among donors. The fact that aid is driven by political motives creates incoherence between donors, and therefore this incoherence may be viewed not as an accidental side-effect, but as an intrinsic dimension of aid.

Divergent incentives: the negative effects of the ‘aid game’ on policy credibility and effectiveness

Aid dependence creates problems of credibility, incentives and moral hazard in the recipient-donor relationship. Aid may be viewed as a game with multiple principals (donors), which is characterised by the divergence of the incentives that drive players. The fiscal behaviour of governments receiving aid suggests that aid affects government expenditure, but also that aid recipients have other objectives that differ from those of donors – which is expressed by the concept of aid fungibility. This divergence between donors and recipients has negative effects on aid effectiveness, but also on the effectiveness and credibility of recipient governments’ policies. The problem of incentives of donors and recipient governments and more generally of the aid game is compounded by the intrinsic problems of coordination among donors.

Even when made of grants, aid is often subject to conditionality, and therefore suffers from the many problems that are inherent to conditionality and conditional lending, which induce mixed responses of recipient governments. Conditionality cannot be efficient, since the aid contract is not time-consistent, which explains the poor results of foreign aid: aid induces weak fiscal discipline and increased fiscal difficulties lead to higher inflow of aid (Svensson, 2000).

Similarly, conditional lending is confronted with divergent incentives, which in fine undermine the effectiveness of recipient governments’ policies: on the side of recipients, conditional loans are an element among many others in politicians’ incentives - political elites are more focused on power than development -, and aid creates conflict over redistribution between groups. Moreover, aid may be used by political rulers in recipient countries as an instrument for implementing their own domestic policy according to a ‘double-edged diplomacy’ where aid conditionalities function as ‘scapegoat’, a strategy analysed by Vreeland (1999; 2005).

On their side, donors give loans to enable old aid loans to be repaid, keep the cycle of flows working and maintain the activity of aid agencies: indeed, aid is ineffective because it expresses firstly the objectives of the bureaucracy of aid. For Martens (2005), the role of aid agencies is not so much to transfer funds to developing countries, but to reduce ex-ante transaction costs and to mediate between the diverging preferences of donors and recipients, and package aid flows in a contract that reduces ex-post uncertainties for donors.

Equally, conditionality is a mechanism that inherently both expresses tensions and triggers resistance: the ‘aid game’, the ‘ritual dance’ may be viewed as an ‘exchange of external finance for economic reform’, as a ‘buying’ of reform, which triggers resistance from governments and fosters policy reversals. Recipient governments promise the multilateral agencies that this time they would reform (as “alcoholics promising never to drink again”).
In fine, aid is typically affected by the ‘Samaritan dilemma’. As shown by Svensson (2005), the recipient government knows that the foreign aid is governed by poverty alleviation, therefore it has little incentives to exert high effort (or channel its own resources) toward this objective. The recipient government has no interest in encouraging interventions that would reduce poverty if a consequence of these interventions is a diminution of aid in the future. Svensson underscores that the ‘Samaritan’s dilemma’ is made worse by moral hazard problems: the donor cannot distinguish if a poor outcome of an aid project is the result of the recipient country’s low efforts or ‘bad luck’.

6. Conclusion

The paper highlights the ambiguity of the concept of aid and the evolutions of global aid flows, and underscore the dependence on aid in certain regions, particularly low-income countries in Sub-Saharan Africa. It reveals the negative impacts of aid dependence in low-income countries, in particular on the capacity of recipient governments to implement developmental and credible policies.

Excessive dependence on foreign aid reinforces the detrimental effects on the policies of recipient governments of the inherent asymmetry in the relationships between donors and recipients: notably the creation of ‘aid traps’, the weakening of the state-citizens social contract, and the exacerbation of the divergence in incentives between donors and recipients that emerge in the ‘aid game’. In low-income countries aid dependence may thus create vicious circles, self-reinforcing ‘traps’ and cumulative processes: the erosion of the effectiveness of recipient governments generates economic stagnation, which in turn makes external aid more necessary, hence creating the conditions for aid dependence and further policy ineffectiveness.

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