Chapter 9

Where Will the Money Come From: Resources

Summary

To accelerate income growth towards seven per cent, and to spur strong progress towards the Millennium Development Goals, the volume and quality of external aid to sub-Saharan Africa must change radically. To ensure effective absorption, increases in aid over the next three to five years should be strong and measured. They must also be accompanied by continued improvements in governance in aid-recipient countries, by substantial changes in donor behaviour, and by learning and evaluation. Past experience shows aid can be provided and used badly. But more and better aid can support positive changes, as demonstrated by recent advances in many African countries, including Senegal, Mali, Burkina Faso, Ghana, Benin, Ethiopia, Uganda, Tanzania, and Mozambique.

This chapter proposes:

- **Doubling aid levels** over the next three to five years, to complement rising levels of domestic revenue from growth and from better governance;
- **Financing increases in aid** by meeting existing commitments to move toward the 0.7 per cent ODA/GNI target, by raising additional finance from an International Finance Facility (IFF), and by developing international levies (for example, a tax on airline tickets) with revenues dedicated to development;
- For poor countries in sub-Saharan Africa which need it, **the objective must be 100 per cent debt cancellation** as soon as possible. This must be part of a financial package for these countries – including those excluded from current debt schemes – to achieve the MDGs, as promised in Monterrey and Kananaskis. The key criterion should be that the money be used to deliver development, economic growth and the reduction of poverty for countries actively promoting good governance;
- Improving radically **the quality of aid,** by:
  - Strengthening the processes of accountability to citizens in aid-recipient countries;
  - Allocating aid to countries where poverty is deepest and where aid can be best used;
  - Providing much stronger support to advancing governance where conditions for effective use of aid are currently weak;
  - Channelling more aid through grants, to avoid the build-up of debt;
  - Aligning more closely with country priorities, procedures, systems, and practices;
  - Providing aid more predictably and flexibly over the longer term;
  - Protecting countries better against unanticipated shocks.

9.1 Introduction

1 Previous chapters have shown, by bringing together evidence and analysis, that a major effort is needed to break free from the problems that have constrained Africa's development and led to long-term stagnation. Business more-or-less as usual is likely to produce outcomes more-or-less as usual – in other words, continued stagnation. After considering the challenges involved, we argue that there is a case for boosting public expenditure – on vital areas such as education, health and infrastructure – by an additional US$75 billion a year, through a large programme of public investment and social expenditure through various international, regional, and national initiatives.

2 As Africa's capacity to absorb a large volume of additional resources in the near future is likely to be constrained, we propose, on the basis of a careful analysis of absorption issues, that half of the US$75 billion per annum extra expenditure be made by 2010. While roughly one-third of this increase could, and should, be financed by African governments, the majority of the finance for this expansion would have to come from the international community. We recommend that the international community increase annual aid flows to Africa by US$25 billion per annum over the next three to five years.

3 The key actors in such a major effort will be Africans. Where African countries move resolutely towards improving their policies, and take measures to expand domestic sources of finance and reform public financial management systems, the international community should act strongly in support, and thereby honour their Monterrey commitments – "no country genuinely commited to poverty reduction, good governance and economic reform wil be denied the chance to achieve the MDGs through lack of finance". This chapter focuses on the importance of finance, but within an overall package of measures discussed in earlier chapters. The perspective it offers is that while aid to Africa will rise in the medium term as resources for poverty reduction and growth are frontloaded, in the longer term, Africa's reliance on external assistance should decline.

4 In the next section we show that Africa is very unlikely to achieve the rapid growth in finance and human development necessary to halt or reverse its relative decline without a strong expansion in aid. In section 3 we present the evidence on how extra aid can be used effectively. In section 4 we discuss how extra aid relates to the issue of debt relief. Finally, in section 5 we consider options for the developed countries for raising the resources for extra aid.

9.2 Can Africa finance a big push without extra aid?

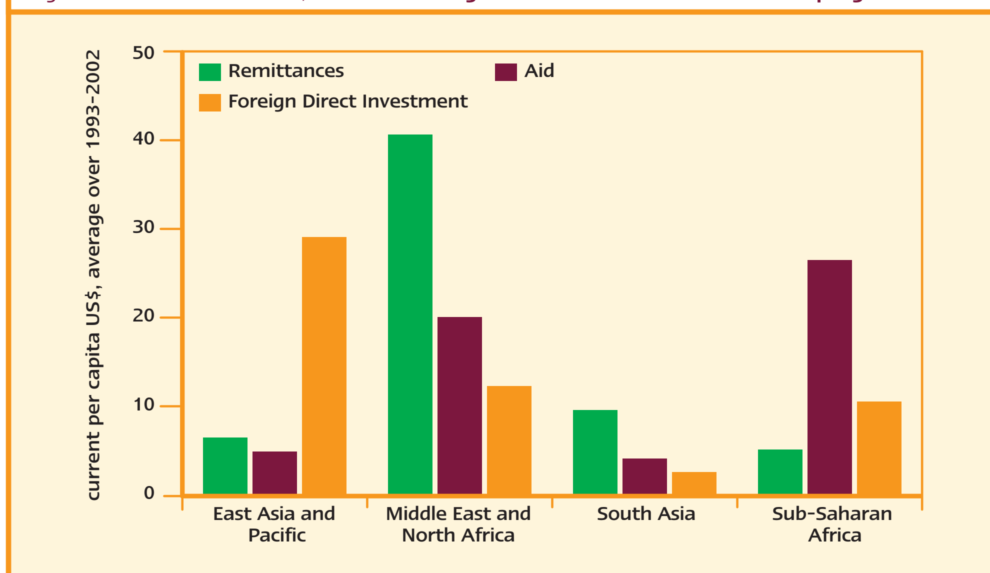
5 As China and India have demonstrated, a low-income country can grow rapidly without much aid. China has very high savings rates and has managed to attract large inflows of private capital, especially Foreign Direct Investment (FDI), while India has attracted significant inflows of remittances (see Figure 9.1). Can Africa follow either of these routes?

Can FDI kick-start African growth?

6 Africa already attracts Foreign Direct Investment. As Figure 9.2 shows, FDI to sub-Saharan Africa has not been insignificant in per capita terms. In contrast to China, however, FDI to Africa has generally not been associated with broad-based growth.

7 FDI to Africa is dominated by the extractive industries: oil and minerals. Figure 9.2 illustrates that three countries – Nigeria, South Africa, and Angola – dominate, accounting

Figure 9.1 **Remittances, Aid and Foreign Direct Investment in Developing Countries**



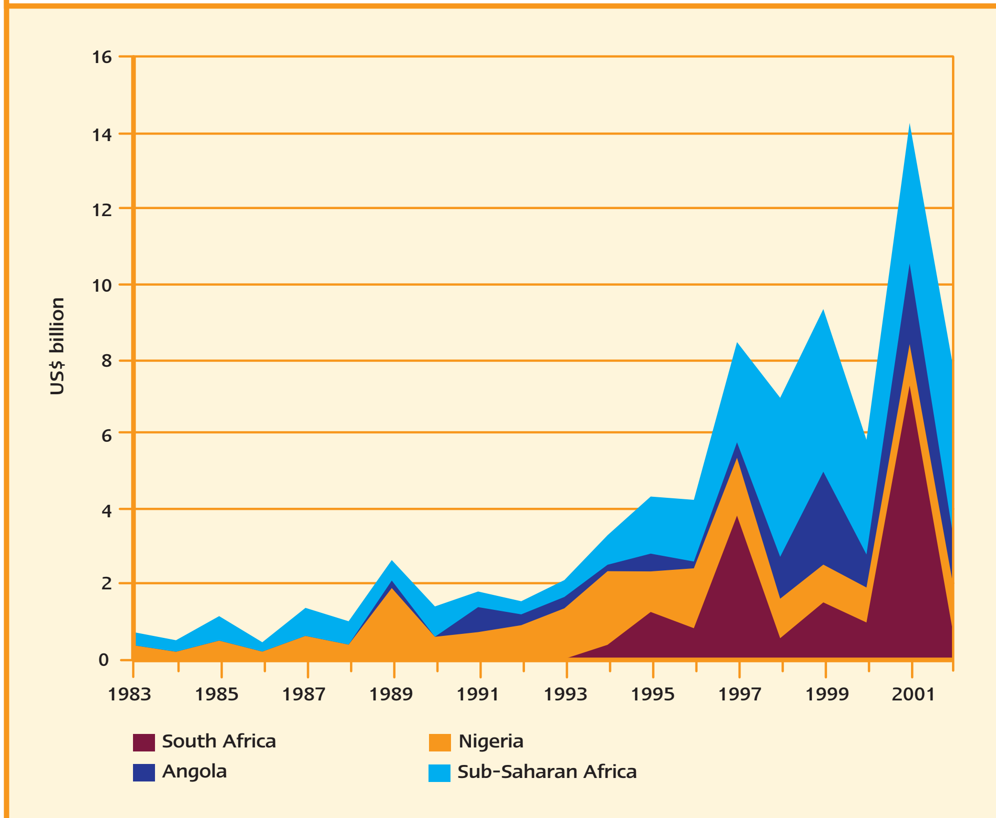
Sources: World Bank, 2004a and 2004b.

for 59 per cent of all FDI flows to sub-Saharan Africa. Investment in the extractive industries often thrives on risky conditions and weak governance because companies can strike highly advantageous deals. For example, when the rebel leader Jonas Savimbi was killed, ending the civil war in Angola, the share price of companies with large Angolan diamond interests[1] fell. These extractive industry companies were doing well out of war. As discussed elsewhere in this Report (Chapter 4), a strategy of development through extractive industries is difficult and requires a high degree of transparency. This is why the Commission is urging a strengthening of the Extractive Industries Transparency Initiative (Chapter 4), agreement of a common definition of 'conflict goods' (Chapter 5), and changes to the OECD guidelines on multinational enterprises to cover behaviour in conflict situations (Chapter 5). It also recommends that the UN maintain a standing capacity to monitor these and the implementation of sanctions.

8 Africa could benefit from a substantial expansion in other types of FDI. In other developing regions, international companies are playing a significant role in developing infrastructure such as in telecommunications, electricity, and water, although their contribution to the finance is minor from the perspective of infrastructure as a whole. This has started to happen in Africa, albeit hesitantly, with successes mainly in telecommunications. Most importantly, FDI is likely to be vital for breaking into global markets for manufacturing for many countries in Africa.

9 Investment in both infrastructure and export manufacturing is highly sensitive to risk – the opposite of what is true for the extractive industries. Infrastructure is necessarily subject to regulation, and this exposes such investment to political risk. Companies in export manufacturing work on very narrow margins and are highly sensitive to even modest levels of risk. For Africa to attract significant amounts of FDI in these sectors, a radical change in international perceptions of risk is required. In part this can be addressed by better arrangements for political risk insurance, and in Chapter 7 we propose a strengthening of the Multilateral Investment Guarantee Agency (MIGA). However, the reality is that a big expansion in such FDI is likely to *follow* rather than lead in the financing of African development. Growth rates will need to rise, and risks be seen to

Figure 9.2 **Gross Foreign Direct Investment in Sub-Saharan Africa**



Source: World Bank, 2004a.

decline, in order to induce substantial shifts in international investor behaviour, and even then, responses are likely to lag behind economic improvements.

Can remittances kick-start African growth?

10 Remittances are a key source of finance for developing countries, and globally have risen from US$20 billion to nearly US$100 billion between 1983 and 2003, long ago overtaking official capital flows. They are now the second largest source of development finance, after FDI[2]. Their flows to the poorest countries are counter-cyclical (whereas private capital flows tend not to be), and are more stable and evenly spread across countries. Remittances are thus a highly attractive source of finance. Africa receives a far lower volume of remittances than do other developing regions. Why is this and what can be done about it?

11 Remittances require remitters: that is, migrants earning good incomes in high-income countries. There are several reasons why African remittances are relatively low. Africa has few remitters because compared to other regions, it has had relatively few emigrants. International migration is now highly restricted. This is the major difference between the globalisation of the nineteenth century and globalisation now. Legal limitations on migration make it difficult for many migrants to remit regularly, especially through official means. Africa also has low remittances because people who do emigrate tend to have lower earnings than more educated emigrants from some other regions, and so are less able to make remittances. Financial conditions within Africa have often not helped. The costs of making remittances are often high, and holding deposits in the domestic financial

sector may be regarded as risky. Financial-sector reforms, improvements in the investment climate, and better access to ICT could thus increase the volume of remittances.

12 Increased education and financial-sector reforms are going to take time. Remittances predominantly reflect the *stock* of emigrants and so are unlikely to become as large for Africa as for South Asia in the foreseeable future. Thus a positive response is likely to come about after an interval of time, and as improvements in the investment climate start to take effect.

Can the reversal of capital flight kick-start African growth?

13 Africa has had more capital flight relative to its own wealth than any other region[3]. If this wealth could be returned to Africa, it would indeed make a major difference to Africa's capacity to finance its development. What have been the big drivers of African capital flight, and how can it be reversed?

14 One driver has probably been corruption. An important step that the governments of developed countries can take is to help African countries make it harder for government officials to loot its assets. Laws and practices must be changed to require international banks to inform on such deposits and to repatriate them to the proper authorities. The Commission has made proposals for such measures in Chapter 4.

15 Another driver of capital flight is high indebtedness. As we discuss in section 4 of this chapter, high debt is a signal of high future taxes (as governments will seek to raise revenues to service debts), which in turn creates an incentive for people to move their money out of the country. Again, this is something that the governments of developed countries can address by helping African countries to reduce levels of indebtedness.

16 But capital flight is also driven by purely domestic conditions, such as high perceived risk and a poor investment climate. For Africa, these include the low level of security of property and person in some countries as a result of violent conflict and crime. These conditions can be remedied, but they take time. Like FDI and remittances, the reversal of capital flight offers substantial eventual rewards, but it is likely to follow rather than lead development. As we discuss in section 3 below, there is good evidence that aid is itself directly part of the remedy to capital flight.

Can higher African savings kick-start African growth?

17 Savings rates in Africa are low, averaging around 16 per cent of GDP[4]. They will undoubtedly need to rise substantially to finance the high investment rates required for sustaining rapid growth. Higher savings can come from either households or government.

18 Could a large increase in household savings rates stimulate African growth? The main reason for doubting that it could is that household consumption is already very low: it is low consumption that is the visible manifestation of poverty. For household savings to stimulate high growth rates across Africa, the already low level of consumption would need to be reduced further still. Such a reduction would surely be undesirable. Indeed, at low levels of income the distinction between consumption and investment blurs: reduced food consumption would reduce health and the ability to work, and hence food expenditure could be viewed as an investment. Higher private savings will be a necessary use of higher incomes, but they will follow the growth of income rather than lead it.

19 Estimates for developing countries show that a doubling of per capita income raises long-term private saving by 10 percentage points of disposable income[5]. Findings based on investigating the savings behaviour of households in developing countries confirm

that the ability to save increases substantially only once a certain threshold in consumption is passed[6]. The importance of a strong financial sector in stimulating higher savings, however, should not be underestimated[7].

20 The alternative way of raising the domestic savings rate is for governments to use tax revenues for public investment. For public savings to lead growth, governments would either have to shift their expenditures away from public consumption or raise tax revenues.

21 In general, it is hard to see where African governments have the scope for substantial cuts in public consumption. Better security assistance may allow some reductions in military spending, but this spending is already modest by international standards[8]. Even major cuts would be unlikely to release more than one per cent of GDP. Large parts of the recurrent budget are spent on non-discretionary items, such as interest payments (13.5 per cent of total expenditure in 2002) and wages (24.2 per cent)[9]. As with private consumption, much of the recurrent expenditure of African governments is perhaps better thought of as investment: spending on health and education builds 'human capital', and spending on the police and judiciary builds a better investment climate.

22 Do African governments have the scope to raise tax revenues? Could a big push in public investment be financed by African taxpayers rather than by taxpayers in developed countries? The comparison between regions shown in Table 9.1 suggests that the average

Table 9.1: **Average Central Government Tax Revenue: Developing Countries 1994-1998 (per cent GDP)**

Region	Tax/GDP (per cent)
East Asia & Pacific	10.0
Latin America & Caribbean	16.8
South Asia	9.2
Sub-Saharan Africa	19.4
Europe & Central Asia	20.1

Note: it should be taken into account that these figure are for central government. India for example has substantially decentralised its tax system and the number for South Asia could hence be biased downwards.

Source: World Bank, 2004b.

tax revenue in Africa is already broadly in line with those of other developing regions. Indeed, given relatively low incomes, the tax effort in Africa is relatively strong. A recent study of 120 countries over a twenty-year period found the average tax-to-GDP ratio to be 20 per cent[10]. In 2002, the ratio for sub-Saharan African countries was 19.4 per cent[11].

23 In the poorest countries of sub-Saharan Africa, the story is different. Despite internationally comparable tax rates, the tax revenues generated are not high because of the structure of African economies. A substantial part of Africa's estimated GDP is generated by 'subsistence' activities, such as food, agricultural, and handicraft produce consumed within the household. Such activities are intrinsically difficult to tax. The 'formal' sector of the economy, which is the normal base for taxation, is often very small. Indeed, at the taxable end of the spectrum of activities, Africa has rather high tax levels. An important indication of this is that a large proportion of its tax revenue comes from taxes on international trade, indeed, the share is much higher than in any other region[12]. Such taxes are generally seen as damaging:

developed countries, despite raising a far higher share of tax revenue in GDP, have virtually scrapped trade taxes. Raising taxes even higher would risk damaging economic activity.

24 Tax revenues in Africa will gradually need to rise to finance higher levels of public spending. But for this rise to complement rather than impede the growth process, a country needs first to build the taxable base of the economy. Growth itself is the strongest factor increasing the tax base, but the base can also expand by enlarging the formal sector. During this 'first phase' taxes need to stay modest. Even once the formal sector has grown as a proportion of the economy, there will need to be a phase of building tax compliance and the integrity of the revenue-raising system[13], during which modest tax rates should be maintained.

25 In short, it is always feasible to raise tax revenue, but it is not always wise to do so. As growth takes root and the modern economy develops and tax administration is reformed, there is scope to augment revenue in ways that do not damage growth, and strong efforts to do so should continue. If aid leads, revenue can follow and eventually replace it. Thus, a reliance on external assistance will be necessary over the medium term, but will persist for the long term only if aid and reforms fail to ignite the growth process.

Conclusion

26 As seen in Chapter 2, between 1970 and 2000 Africa stagnated. Marginal increases in aid will not allow Africa to escape stagnation. A big push is needed and an essential part of this big push will be a major increase in investment. In this section we have considered ways in which such a quantum increase in investment could be financed other than by an increase in aid. We have found no credible alternative.

9.3 How can extra aid be most effective?

27 Efforts to refocus the African public sector on investing in infrastructure, health, education and training, and on fostering private activity, would need initially to be financed mainly by aid[14]. Is there any evidence that such aid-financed expenditures would be effective? A reasonable starting point is to see how well aid to Africa has worked in the past. We note that many of the weaknesses in aid programmes that have been identified can be rectified, so that the future should be much better than the past. However, past performance provides a useful benchmark.

9.3.1 Aid: the record of achievement

Aid-financed projects in Africa have typically had high returns

28 Among the aid agencies, the World Bank carries out the most rigorous analyses of returns on its projects. It finds that average economic rates of return in Africa were 22 per cent for the 1994-2003 period[15]. Its projects have also been showing significant improvements in terms of sustainability and institutional development impact[16].

Aid increases access to education and improves educational outcomes

29 Budget support to Tanzania has enabled the government there to double per capita spending on education, as outlined in their poverty reduction strategies between 1999 and 2003[17]. The same external assistance, including debt relief, has made it possible for the Government of Tanzania to introduce a policy of free and compulsory education in 2002, benefiting 1.6 million children[18]. Increased aid is enabling governments in many more African countries to abolish primary school fees and increase access.

30 A World Bank Operations Evaluation Department (OED) study of World Bank support to schooling in Ghana over a 15-year period shows enrolment rose by ten per cent. The quality of schooling rose too: while nearly two-thirds of primary school graduates were illiterate before (that is, they scored two or less on a simple eight-question multiple choice English test), this had fallen sharply to one in five in 2003. The gains in educational outputs were clearly related to improvements in the quality of schools (better infrastructure), more trained teachers, and a greater availability of school textbooks[19].

31 Substantial external support to building infrastructure, and supporting teachers' salaries, and teacher training in Ethiopia has enabled gross primary school enrolment to rise from 20 per cent in 1991 to 63 per cent in 2003. Progress has been especially notable in the rural areas and among girls, who now represent 40 per cent of total primary enrolment[20].

32 Support to The Gambia's education strategy has had successful outcomes across the sector. Through increasing public expenditure on education from 2.6 to 4.3 per cent of GDP, improvements have been made in the accessibility and quality of mainstream and vocational training, in non-formal and early childhood education, and in building management capacity. Applying a participatory approach was key to this success, particularly in addressing gender disparities – girls' gross enrolment more than doubled from 35 to 75 per cent between 1980 and 2000[21].

Aid increases access to health services and improves health outcomes

33 With aid, Ugandan health authorities have been able to abolish almost totally patient charges and to expand access to basic health care services: since 2000, out-patient attendance has grown by 87 per cent and immunisation rates have grown by 78 per cent[22]. In conflict-affected countries, such as the DRC, aid reached millions of children in 2001 as immunisation efforts were being maintained, and the number of reported cases of polio fell from 603 to zero within 12 months[23].

34 In the Zambian health sector, external aid has helped per capita public expenditure to rise from US$10 in 2000 to US$17 in 2003. Previous declines in outcomes appear to have been halted, and some reversed. Examples include immunisation, use of contraception and antenatal coverage. Infant mortality (under one year old) has fallen from 107 to 95 (per 1,000 births), and under-five mortality has fallen from 191 to 168 (per 1,000 births) over the period 1987-1991 to 1997-2001[24].

35 The eradication of smallpox globally is, to a large extent, the result of more than US$100 million worth of targeted aid. Progress towards the eradication of polio is also the result of internationally funded activities: in 2001, over 575 million children under five were vaccinated against polio in 94 countries, and much of this effort was financed by aid[25].

Several African countries have grown rapidly and reduced poverty with support from large aid programmes

36 In Mozambique, in the 1990s, when aid accounted for about 50 per cent of GDP, GDP growth reached an astonishing 12 per cent. Even more important, Mozambique sustained high growth rates even when the aid ratio fell sharply – suggesting that aid had helped build a foundation for sustained growth[26]. Household surveys show the incidence of poverty fell from 69.4 per cent in 1996/97 to 54.1 per cent in 2002/03, and a disproportionate share of poor people in the rural areas were lifted out of poverty. The percentage of households with latrines increased from 31 per cent to 41 per cent, and the mortality rate of children under five declined from 277 to 135 per 1000 living births

between 1994 and 2002. Between 1999 and 2003, the overall number of students in primary and secondary education increased by 43 per cent[27].

37 Few countries have such high aid/GDP ratios, but there are other high-aid successes. Uganda received over 20 per cent of GDP in aid in the early 1990s, achieved decade-long growth rates of over seven per cent, and reduced the proportion of people living below the poverty line by over 20 percentage points. In other areas, Uganda has also made good progress: the HIV prevalence rate has fallen from an estimated 20 per cent in 1991 to 6.5 per cent in 2001; and net enrolment in primary schools has risen from 62 per cent in 1992 to 98 per cent in 2003[28]. Ghana received aid of around 10 per cent of GDP over the past two decades, during which growth averaged nearly five per cent. And, poverty rates fell from 51.7 per cent in 1991/92 to 39.5 per cent in 1998/99. The proportion of Ghana's rural population with access to safe water increased from 40 per cent in 2000 to 47 per cent in 2003[29]. Since the genocide ten years ago, Rwanda has made huge progress: there is peace, recent economic growth was over six per cent, and the incidence of poverty fell from around 70 per cent in 1994 to under 60 per cent in 2001, with aid levels persistently above 15 per cent of GDP[30].

Cross-country research shows aid supports growth

38 The above examples are consistent with more aggregate evidence. Econometric analyses predominantly find that aid raises growth[31]. A recent and thorough study[32] concluded that 'short-impact' aid – by which the authors mean budget and programme support, and aid to infrastructure development, agriculture and other productive sectors – had raised growth in Africa by more than one per cent. Without aid, in other words, Africa would have experienced severe decline[33]. The finding that aid is effective does not depend significantly on country circumstances, even though (unsurprisingly) aid tends to work better where policies, institutions, and governance are better.

Aid raises investment

39 The effects of aid on investment are indeed positive. A study by Collier and Dollar (2004: 268) shows that in a typical developing country (i.e., in their study one receiving aid at about two per cent of real GDP in Purchasing Power Parity (PPP) and with average policies) an additional one per cent of GDP in aid is associated with an extra 0.9 per cent of gross investment. Aid does not substitute for policy, but complements it: in better policy environments the favourable effect of aid on investment is doubled.

Aid reduces capital flight

40 Africa has had more capital flight, relative to its wealth, than any other region. While some people accuse aid of fuelling capital flight, recent research finds precisely the opposite: aid significantly and substantially reduces capital flight[34]. The movement of private capital is scaled up by aid because wealth-holders choose to retain their capital in domestic currency when they perceive improvements in the investment climate. For every US$1 of aid, an equivalent of US$0.40 worth of domestic investment is induced that might otherwise have left as capital flight.

Aid helps countries to improve institutions and governance

41 Recent research finds that aid of the right type and timing substantially increases the chances that a country will achieve a sustained turnaround from weak institutions and governance[35]. With carefully designed technical assistance and the provision of post-primary education, it is possible for aid to improve the institutional environment. One example of this gradual process of turnaround assisted by appropriate aid is Ghana,

which has evolved from a coup-ridden country to a democracy that is sustaining growth. Another example is the turnaround in Ethiopia during the past decade. The experiences of Ghana, Ethiopia and Mali are described in more detail in Annex 1, Annex 2 and Annex 3 of this chapter.

Aid helps to reduce violent conflict and rebuilds post-conflict societies

42 Aid has the potential to contribute to conflict prevention through its effects on the growth and level of income, which are key factors in reducing risk[36]. Strong and sustained aid is vital for rebuilding countries emerging from conflict. As discussed in Chapter 5, the ability of aid to fulfil this potential will depend on the timing and type of funding. To be effective at preventing conflict, aid decisions must reflect an understanding of the potential drivers of violent conflict in recipient countries, especially those countries emerging from conflict. Rapid financing to meet short-term needs is essential, but to contribute to long-term stability and development, aid must be sustained for at least a decade following the end of war[37]. Donor co-ordination is particularly important for enhancing effectiveness in post-conflict contexts. As discussed in Chapter 5, in the case of

Box 9.1 **Aid, Growth and Poverty in a Post-Conflict Environment: the Case of Rwanda**

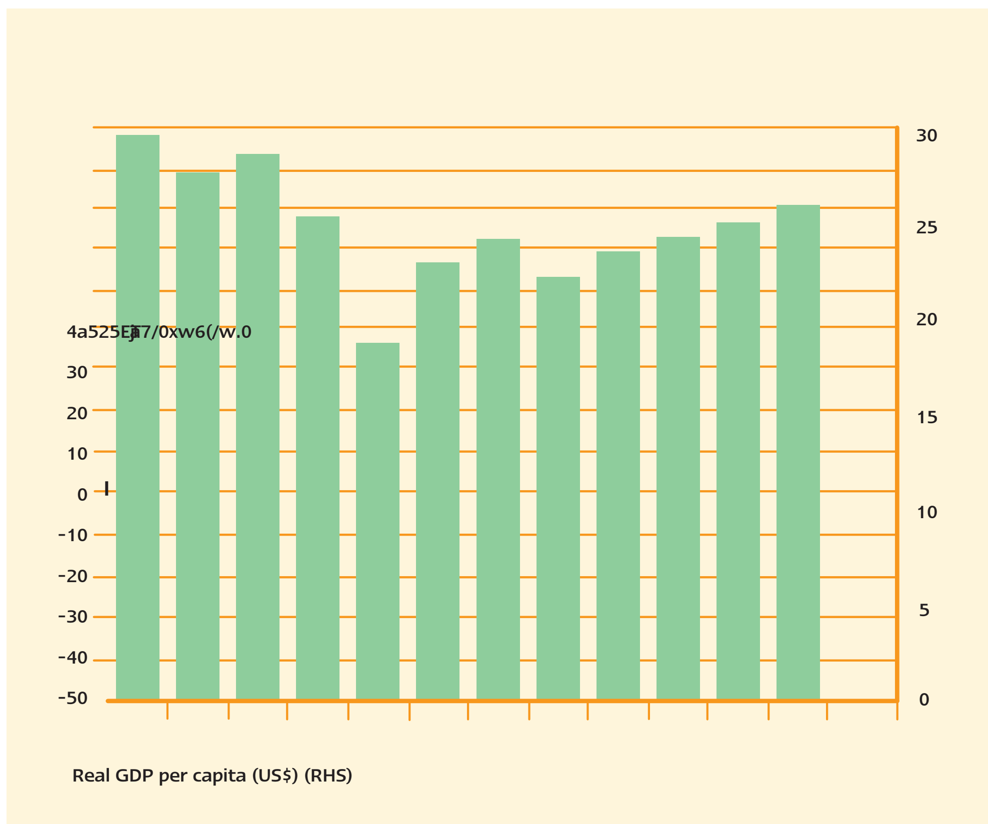
Post-conflict environments present particular challenges for delivering effective aid. The case of Rwanda, which experienced civil war and genocide between 1990 and 1994, shows that a country emerging from conflict can make productive use of aid. Moreover, aid was effective not only for humanitarian purposes, but also to stimulate economic growth and reduce poverty over an extended period.

Figure 9.3 shows that Rwanda managed to restore real per capita income to pre-genocide levels in 2001. Economic growth has been sustained throughout the 10-year post-conflict period. The inflow of aid has been substantial, peaking at 54 per cent of GDP in 1995, but still averaging almost 20 per cent over the 1997-2001 period. Rwanda's record in macroeconomic and public financial management (especially in revenue) has generally been considered good.

Research at the World Bank on growth patterns in post-conflict countries shows that the intensity of Rwanda's economic recovery during the first couple of post-genocide years was higher than for other civil wars and this despite the near total destruction in the capital stock and the extremely high death rate[38]. The IMF increasingly acknowledges there might be a good case for increasing aid to post-conflict countries beyond what IMF staff normally see as being in line with sustainable fiscal policies[39,40].

The successful growth effort can also be attributed to the quick rebuilding of key institutions. Even though educated people were an explicit target for the genocidaires, Rwanda's overall Country Policy and Institutional Assessment (CPIA) has seen one of the fastest increases in the whole of sub-Saharan Africa, and is now well above the average for sub-Saharan Africa.

Mozambique, innovative responses from the international community helped greatly. Rwanda provides another recent example of effective post-conflict assistance. See Chapter 5 for further discussion and recommendations on making aid more effective in reducing the risk of violent conflict, and in building peace after the cessation of conflict.



Aid helps countries to withstand shocks to export prices

43 Compared with other regions, Africa is much more exposed to fluctuations in the prices of commodity exports. When prices crash, as happens periodically, economies contract. Research finds that aid is particularly valuable to the most shock-prone economies, especially when timed to coincide with adverse shocks, when it protects the economy from contraction[41].

9.3.2 Aid: the scope for enhanced effectiveness

44 Past evidence on aid effectiveness necessarily reflects past conditions in Africa and past aid practices. Growth in Africa has not been vigorous despite strong aid flows in the past. To a significant extent this is due to the low quality of aid provided and poor conditions of governance. Conditions for using aid productively in Africa have improved in recent years, suggesting that results from current aid may be better than the past. Since the end of the Cold War, aid has been provided to recipient countries more explicitly for financing development[42]. Donors are more focused on giving aid for reducing poverty; evidence of this includes HIPC II debt relief, increased aid selectivity, and the Poverty Reduction Strategy (PRS) approach. Many African countries have experienced a sustained period of macro-economic stability, reasonable economic growth, and improved political and economic governance. Regional institutions are better poised in guiding assistance towards improving the conditions for longer-term growth.

45 Despite these improvements, the system for allocating aid to African countries remains haphazard, unco-ordinated, and unfocused, to a degree that should be

unacceptable. Aid is supplied by many donors, each with multiple, and often opaque, objectives; provided in a variety of forms; accompanied by many onerous conditions that are often of dubious value; and is channelled to countries unpredictably[43]. Not all aid is presently provided to countries with the primary objective of overcoming poverty, for example, in the sense of meeting the MDGs. As Birdsall (2003) suggests, donors continue to commit errors that, at best, reduce the effectiveness of aid, and at worst, undermine recipient countries' long-term development prospects.

46 A mechanism is needed to ensure that a wider range of countries receive assistance of the right kind, and that African countries have a greater role in guiding allocation decisions and recommending criteria. **Recommendation: To improve the quality of aid an annual discussion should take place between the Development Ministers of the OECD countries and African Finance Ministers, along with representatives of civil society and international organisations. This should consider aid allocation criteria and make suggestions for a better distribution, including between middle and low income countries. In countries where governance and institutions are weaker, donors should seek to provide adequate and effective flows through appropriate channels, bearing in mind the need to avoid undermining national systems and/or long-term sustainability.** A mechanism for an annual dialogue could provide a regional forum for discussing a range of supporting actions that the international community should take, including the volume and the form of finance (Annex 4).

47 A background study undertaken for the Commission found:[44]

(a) *Misalignment:* Aid is rarely aligned with recipient countries' national budget cycles. Donors' commitments remain unpredictable, and pledging is seldom multi-year (although multilateral assistance is more predictable and is reliably channelled to priority sectors through budgets). African governments perceive donor resources to be insufficiently flexible to allow them the manoeuvring room to switch funds and meet new priorities in the face of exogenous shocks;

(b) *Donor rather than country priorities:* Donor conditionality (especially of the IFIs and ADB) remains high and can be inconsistent with recipient countries' national policy and performance priorities. There is a strong perception that overall conditionality has increased under PRSPs. Some donors are continuing to channel resources to non-priority (donor-selected) projects;

(c) *Complex procedures:* Overall, disbursement, reporting, and monitoring and review procedures of the IFIs, multilateral institutions, and donors are demanding, cumbersome, time-consuming, and cause delays.

48 The assessments from the study highlight the lessons that have been learned about aid delivery and that the application of these lessons has far to go. Translating these lessons, we suggest the following:

(a) The most efficient way of giving aid is through direct budget support (DBS). DBS supports directly the Government's development priorities, and keeps transaction costs at a minimum. It should be predictable and long-term. The case for DBS requires that there should be a very clear development strategy in place. It only works where the budget system is open and transparent. Governments needs to report clearly how (and how effectively) resources have been utilised, which not only fulfils accountability requirements, but forms the basis for future allocations.

(b) Where these conditions have not been completely fulfilled, programme support (giving financial and technical support to a particular sector) may be a more

appropriate option. Where the overall environment is less conducive to either of these forms of assistance, support for specific projects may be more appropriate. We encourage donors to move wherever possible along the spectrum from project aid to programme aid, and from programme aid to budget support. In any case, wherever project assistance is given, it should be fully in line with the government's development priorities.

(c) In 'fragile' states, none of these options may be possible or appropriate, either because there is no effective government to deal with, or because resources cannot be accounted for properly. In those cases, it might be necessary to provide support (either from donor Governments or through intermediaries) direct to NGOs and civil society organisations (see also 9.3.5).

9.3.3 Improving the quality of aid

49 Regarding the influence of the quality of aid on African development, Elbadawi and Gelb state[45]: "if the quality of aid in sub-Saharan Africa rose by 24 per cent (to reach the median of the aid-dependent countries in the sample), per capita GDP growth in sub-Saharan Africa would rise by about 1.8 per cent per annum". The effect of improving the quality of aid delivered to sub-Saharan Africa is thus very powerful. The Commission believes that it is both feasible and important to improve aid effectiveness radically. To this end, it proposes the following recommendations.

50 **Recommendation: Aid to Africa should be mainly in the form of grants.**

51 Grants have two major advantages over loans. They do not become a future debt problem, and they enable greater flexibility as to the choice of recipient. The volume of grants to a country need only be limited by its ability to absorb aid effectively, whereas loans are constrained by considerations of debt sustainability. After several rounds of debt forgiveness, making serious debt sustainability calculations is difficult. The credibility of further official lending to Africa is undermined if both creditors and borrowers heavily discount the prospects of repayment. It is better to face this reality than to continue to undermine Africa's creditworthiness.

52 Loans are constrained by considerations of the status of the borrower, and in sub-Saharan Africa, this generally means they finance only national-level government. Grants are able to meet a wider range of needs. Much regional infrastructure is best provided by supra-national entities based on regional groupings, to which multilaterals cannot lend. Similarly, sub-national entities such as local governments often have the prime responsibility for service delivery, but may not be regarded by donors as appropriate entities to incur debt. Often the most cost-effective service delivery is provided by faith-based organisations: where government delivery systems are very weak, grants to such non-government organisations are likely to be a better use of money than further loans to governments.

53 Virtually all bilateral aid and all aid from the European Commission is already in the form of grants. The main source of loans is the World Bank. Although World Bank loans are concessional, the grant content of its loans has declined substantially because of the decline in world interest rates. World Bank aid is better targeted towards the poorest countries than is aid from other programmes, so that the present system has the paradoxical consequence that loans tend to be targeted to the poorer countries while grants (from other donors) go to less poor countries. There is therefore a clear need to increase significantly the proportion of grants within IDA[46], in order to allow the World Bank greater flexibility in disbursements. Channelling more resources from various donors through the World Bank would also be the most straightforward way of harmonising aid and raising its effectiveness. Similarly, the UN system could also be used to channel more

resources for capacity building, technical assistance, and institutional strengthening. This would help to expand countries' capacity for absorbing additional resources.

54 **Recommendation: Aid should be untied, predictable, harmonised, and linked to the decision-making and budget processes of the country receiving it. The length of the commitment should be related to the purpose: for example, aid for infrastructure and public expenditure support should be committed for terms longer than aid for technical assistance.**

55 In some countries – especially Uganda, Tanzania, Mozambique, Ethiopia, Ghana, Rwanda, Benin, Burkina Faso, Madagascar – there is evidence of good progress on effective aid delivery, as donors and partner authorities have established formal mechanisms to improve practices and for aid to come in solidly behind national Poverty Reduction Strategy and budget processes. Aid delivery has certainly improved when compared with donor practices in the 1980s and 1990s. But despite this, implementation of new aid approaches linked with HIPC, the PRS, and MDG agenda still retains a 'business as usual' feel about it[47]. Progress is patchy, and as shown in Annex 6, the practice of aid tying remains pervasive, and is estimated to have reduced the value of aid to Africa in 2002 by US$0.7 to 1.3 billion[48]. Most sub-Saharan African governments lack an overarching external financing and aid strategy that provides the complementary framework to PRSs and MDGs. Such a strategy could greatly enhance the effectiveness of the partnership between the country and donors, including the co-ordination among donors.

56 **Recommendation: The use of policy conditionality associated with external assistance should be strongly reduced. Ways of strengthening mutual accountability, and of monitoring implementation, should be put in place. The activities of the IFIs and donors should support, and not undermine, institutions of accountability in African countries, for example by helping countries to strengthen international codes and standards and by avoiding heavy burdens of reporting.**

57 The practical effect of policy conditionality was to make African governments accountable to donors for their policy choices. This was both an infringement on sovereignty and ineffective. While reducing policy conditionality is now widely accepted in principle, its incorporation in the day-to-day practice of donor operations is still poor. This does not mean that African governments should be free from accountability: for aid to be effective, the people whom it is meant to benefit (or their representatives) should be able to hold their governments accountable.

58 Donors should therefore focus on the processes by which ordinary citizens can hold government to account, such as: the transparency and integrity of the budget; the freedom and capacity of the popular media, especially radio, to scrutinise resource use; and the effective functioning of democratic processes of accountability (see Chapter 4). Where these are weak, donors should help to improve them, including by the strengthening of international standards and codes, and do so without introducing excessive conditionality.

59 Regional development institutions are critical for Africa, although they have been relatively under-funded in the past[49]. The African Development Bank (ADB), is gradually emerging from a period when its performance and resources declined (see Chapter 10). It has the potential of being a stronger financial institution and a key provider of development finance having had its AAA financial rating restored. Its policies are broadly consistent with those adopted by other multilateral organisations. It is genuinely African-owned, with a good record of financing a range of activities in Africa. It has a sound plan of action committing itself to change and monitoring progress. It has allied itself with AU/NEPAD as a key partner, and will be leading work on infrastructure. There is a unique opportunity now to ramp up support so that it becomes an even more

effective regional institution capable of supporting PRSs programmatically[50]. Supported by other IFIs and the European Commission, the ADB could also play a greater role in disbursing grants for mitigating the impact of shocks.

60 The World Bank and the IMF are the world's main institutions capable of responding to the challenge posed by African economic stagnation. While they are institutions with global responsibilities, they have not given Africa a priority commensurate with the increasingly exceptional problem that African stagnation has come to represent. There is also considerable potential for the European Investment Bank (EIB) to play a greater role in Africa. The question of how to strengthen the strategic approach and the implementation capacity of these institutions is addressed in the next chapter.

61 **Recommendation: Through a new facility, donors should help African countries to address problems caused by commodity-related shocks and natural disasters.**

62 Most African countries suffer from multiple, frequent and severe shocks. Fluctuating commodity prices and other adverse export shocks are an extremely serious problem for many commodity dependent countries, and generate large multiplier losses in output[51]. Adverse climatic shocks can expose African states to the risk of civil war[52]. For all IDA-only countries, it has been estimated that large shocks occur once every 1.4 years and have the effect of reducing GDP by 4.25 per cent[53]. Such events are particularly problematic in democracies, as electorates face the difficult task of distinguishing between outcomes that are the responsibility of government and those that are beyond its control.

63 African countries are not well placed to bear shocks, because of poverty and the structural reliance on (producing and exporting) primary commodities (see Chapter 8 on trade). For these reasons, part of the risk associated with shocks should be spread internationally. Shocks pose long-term development problems, and not just humanitarian catastrophes at the time they occur; yet whereas humanitarian relief is designed to respond to shocks, development assistance has largely been unresponsive to them. Where development assistance has responded to shocks, the evidence shows it to have been effective, with exceptionally high rates of return[54].

64 Given the frequency of the shocks that hit African countries, and the need for responses to be rapid if they are to be effective, a structured approach is required. Compensating finance should be through grants, since for low-income countries the aftermath of an adverse shock would not be a good time to be increasing debt levels. The objective of external finance would be to cushion the shock, permitting a gradual adjustment should it be long-lasting, and avoiding unnecessary adjustment should the shock be short-lived. It should thus be tapered: aid would provide substantial compensation in the first year of a shock, but phase out around three years after a persistent shock. The cushioning finance would aim to stabilise government finances rather than directly compensate individuals. Typically, large adverse shocks reverberate around the economy and so targeted compensation is impractical, but by stabilising the budget, aid can help to dampen these damaging effects.

65 The key agency with the macroeconomic expertise for designing such a contingent grant facility is the IMF. The IMF itself does not have access to the grants that would be needed, but it could provide the signals by which bilateral or IDA assistance could be provided and co-ordinated. Such automatic grant finance to smooth shocks would considerably facilitate the implementation of IMF Programmes. Given the frequency of shocks in low-income Africa, there is a significant risk that an IMF programme will be derailed by an unanticipated shock.

66 A number of options might be considered for a facility covering shocks, so as to initiate the required structured response internationally, and in which the IMF should play

a key signalling and advisory role. One option worth considering is a special facility within the ADB. Potentially, this might allow more effective implementation and for closer monitoring to take place within Africa. Complementarities with other activities within the ADB would also be strengthened (e.g. those related to its recently-established Post Conflict Country Facility, and the work being undertaken on debt sustainability). Other alternatives might be a special UN Trust Fund, given the UN's existing role in donor co-ordination at the country level; or a revamped facility within the European Commission, operating as a fast-disbursing unit alongside its current mechanism for compensating ACP countries for lost export earnings. Wherever the facility is housed, it should not operate as a large separate entity. Its function should be to analyse shocks and to advise the Board of its institution on appropriate disbursements.

67 Our estimate for compensating African IDA-only countries for GDP losses arising from commodity and natural disaster shocks until 2015 would amount to US$5.6 billion per annum[55]. Of this amount, US$2 billion could be allocated to cushion commodity-related shocks, and US$3.6 billion for natural disaster shocks. Assuming a shocks facility were to cover 75 per cent of resources required to compensate countries for GDP losses arising from a particular shock, and an average commodity shock were to occur twice every seven years and a natural disaster shock twice every five years, US$4.2 billion would be required per annum (US$1.5 billion for commodity shocks and US$2.7 billion for natural disaster shocks). As natural disaster shocks in Africa are already partially covered by other facilities, this facility could focus on compensating countries against commodity shocks, thus lowering its operating costs. Approximately US$3.8 billion per annum would provide full protection from commodity-related shocks, and 50 per cent from natural disasters[56].

9.3.4 Aid: so how much more?

68 **Recommendation: Aid to sub-Saharan Africa should be doubled, that is increased by US$25 billion per annum, over the next three to five years to complement rising levels of domestic revenue arising from growth and from better governance. Following a review of progress towards the end of this period, a further US$ 25 billion per annum should be provided, building on changes in the quality of aid and improvements in governance.**

69 We have seen that aid to Africa has been effective despite deficiencies in delivery mechanisms. A range of practical steps and new aid opportunities can be taken to make aid even more effective in the future. As we have emphasised repeatedly, Africa needs to invest today to address a long list of development challenges: the decline in rural production, the growing problem of rapid urbanisation leading to slums and squalor, the difficulties created by weak infrastructure and poor transport and telecommunications networks, and the lack of adequate public services, especially in health, education, and social protection. Added to these, very large investments are required for tackling the HIV and AIDS pandemic. Frontloaded aid can assist Africa in tackling these changes.

70 By frontloading aid we mean investing a larger quantity of foreign assistance in the immediate rather than in the more distant future. We believe this is not just morally right, in that it will reduce the extent and severity of today's poverty, but is also economically sensible, in that returns to big investments are likely be higher now than later. Many studies show that social and economic benefits of investment financed by aid are very high[57]. Investing now in the education of children, in improving heath standards, in building infrastructure, in slum upgrading, in providing people with clean water, in improving sanitary conditions, is not just good for today's poor people, it establishes a stronger foundation for expanding future economic growth.

Table 9.2a: **Costings of the Commission's Recommendations Taking No Account of Constraints of Absorptive Capacity**

Additional annual public expenditure needed to implement each item of the Commission's package in full (US$ billion)	**75.0**
Composition of Commission's Expenditure Recommendations	**(per cent)**
Governance (Chapter 4)	4.0
Peace and Security (Chapter 5)	2.0
HIV and AIDS (Chapter 6)	13.0
Education (Chapter 6)	10.0
Health (Chapter 6)	26.0
Social Inclusion (Chapter 6)	5.0
Growth, Infrastructure and Trade (Chapter 7, 8)	27.0
Mitigation of Shocks (Chapter 9)	5.0
Contingencies	7.0
Commission's Package of Recommendations (US$75 billion):	100.0

Table 9.2b: **Costings of the Commission's Recommendations Taking Account of Constraints of Absorptive Capacity**

First Stage: 2006-2010 (in US$ billion)*	
Additional public expenditure, by 2010	37.5
Total financing needed	37.5
Domestic resources**	12.5
Extra aid (double 2004 volume)	25.0
Second Stage: 2010-2015	
The Commission recommends proceeding to a second stage (2010-2015) of similar expansion based on an assessment of experience of the first stage	

*Notes: * Breakdown across sectors would be similar to Table 9.2a*
*** Assuming an annual five per cent real growth rate of GDP, and a tax to GDP ratio of 15.7 per cent (based on an average for the period 1993-2002), the extra tax revenue generated domestically within sub-Saharan Africa would amount to US$12.3 billion. If the expected growth rate of seven per cent is achieved, the extra generated domestic revenue would rise to US$18.6 billion. Domestic revenues should also arise from efficiency improvements in tax collection. We assume such gains rising to 0.5 per cent of GDP by 2010. This would provide a further US$1.8 billion (based on assuming five per cent economic growth), or US$2.1 billion (if the seven per cent expected rate is realised). For realism, in the table above we use a slightly lower amount (US$12.5) billion as sub-Saharan Africa's domestic resource contribution. (Given South Africa's high shares in sub-Saharan Africa's key macroeconomic aggregates, these estimates exclude South Africa.)*

Source: Commission's estimates

71 Together, the Commission's recommendations constitute a coherent and integrated package of measures. There are mutually beneficial effects to be realised from investing in this package as a whole. These benefits would be lost if investment efforts were piecemeal and spread across a period of time. In responding to evident capacity constraints in poor countries, it may at first seem sensible for donors to scale down, and stretch-out, the aid effort over time. But if this approach *reduces* overall effectiveness, this would be counterproductive and a waste of good aid. Donors should therefore desist from repeating mistakes made in the past when confronting very real absorptive capacity problems. As we have argued throughout this Report, a critical mass of sensibly-invested interventions financed by frontloaded aid will improve social conditions and accelerate growth. Over time, the latter will in turn generate the domestic resources required to finance development, and this should eventually reduce the need for more aid.

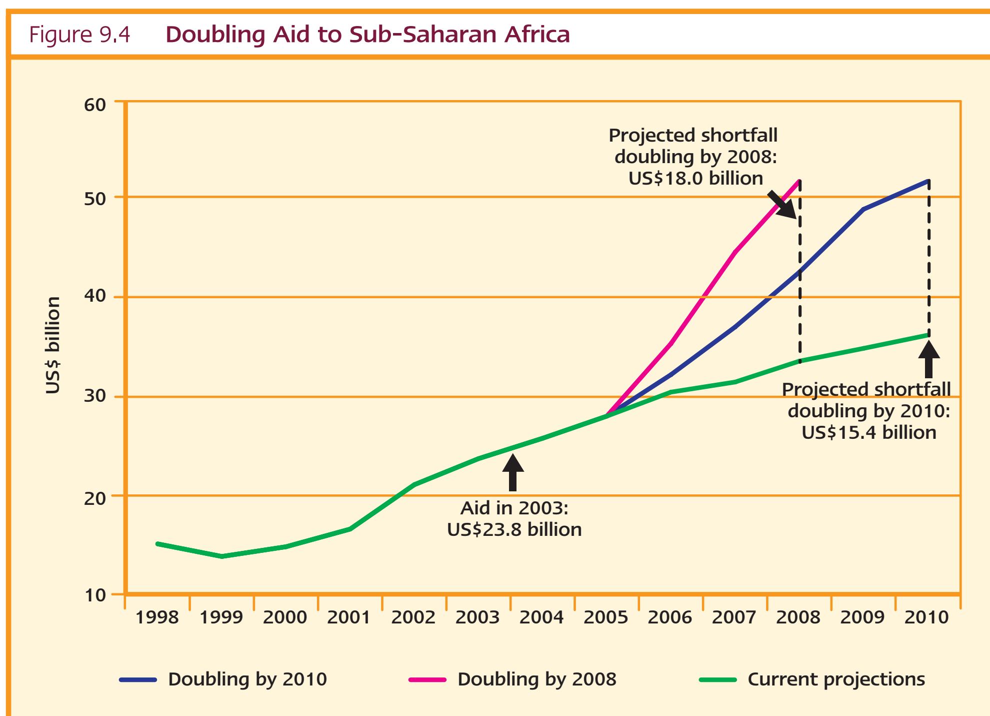
72 Table 9.2a draws together the financial implications of the recommendations that the Commission proposes in this and earlier chapters. The sectoral priorities listed are suggestive rather than definitive, although they have emerged from detailed analysis and many consultations. Actual priorities and implementation plans will inevitably be shaped by country, regional, and continental processes within Africa. We must emphasise that the total cost indicated in Table 9.2a is an aggregation of the Commission's recommendations and takes no account of absorptive capacity issues.

73 To accelerate income growth towards seven per cent, and to spur strong progress towards the Millennium Development Goals, the volume and quality of external aid to sub-Saharan Africa will need to change radically. As Table 9.2a shows, if the Commission's recommendations were implemented fully, taking no account of problems of absorptive capacity, public expenditure would need to rise over the 2006-2010 period to reach an extra US$75 billion in 2010. However, throughout the report we have emphasised the importance of being measured in implementing an ambitious programme, despite the great urgency in meeting needs. It would be reckless for the international community not to respond strongly to the enormous challenges of accelerating human development in Africa. It would be negligent, however, to set about tackling these without giving adequate attention to evident capacity constraints in planning, budgeting, administration, and management. Accordingly, our recommendation is to proceed in two stages (Table 9.2b). In the first stage of three to five years, only half the package would be implemented and our analyses of absorptive capacity indicates that this could be implemented effectively. Before embarking on the second stage, an assessment would take place of experience: considering advances in governance and in aid quality. To allow meaningful assessment, it will be crucial to build monitoring and evaluation into the scaling-up of aid programmes. An allowance is made both for unforseen increases in programme expenditure due to sudden price increases, and to allow some flexibility in adjusting the size of some programmes[58]. (For a more detailed breakdown of cost estimates, see Annex 5.)

74 We provide below, and in Annexes 1, 2, 3, and 6, the analysis to support our argument that half the full package could be absorbed over the first stage of three to five years. To attempt a faster scale-up in expenditure would require even bigger improvements than we expect in the quality of aid and in countries' ability to use resources effectively. The build-up over three to five years should be measured in pace, justified by bottom-up costs, and be based on a very careful analysis of absorption issues. Moreover, a rapid acceleration in expenditure may not be feasible, and is unlikely to be sustainable. New capacity created over the next five years should make it possible for higher levels of funds to be absorbed productively in the future.

75 In the first stage, it should be possible for *one-third of the required new resources to be raised domestically, and two-thirds from external sources.* We expect that the one-third domestic contribution will be financed from resources arising out of economic

Figure 9.4 **Doubling Aid to Sub-Saharan Africa**



Sources: OECD/DAC, 2004 and 2005 and Commission's estimates

growth. With a constant tax-to-GDP share of 15.7 per cent[59], and some efficiency gains in the collection of taxes, we anticipate that in 2010, the contribution from sub-Saharan Africa would amount to at least US$12.5 billion (see Table 9.2b)[60].

76 The remaining two-thirds of the required additional expenditure should come from external concessionary resources. These external funds come to an *extra US$25 billion over the next three to five years* (2006-2008/10) – a mere US$0.10 extra per person per day in Africa[61].

77 The proposed doubling in aid is realistic and feasible. If projected growth in aid flows to Africa during 2004 and 2005 is realised, the average annual percentage increase in aid will have been about 11 per cent per annum between 2001 and 2005. This rate has allowed current aid levels to Africa to be partially restored to 1990 levels[62]. As noted earlier in this chapter, aid to Africa declined substantially during the 1990s.

78 For aid to double between 2005 and 2008, the average annual percentage increase would amount to 22.5 per cent; if the period for the doubling was extended to 2010, the increase would be 13 per cent per annum. Our recommendation for a doubling is therefore ambitious, but, at least if extended to 2010, only moderately faster than the first half of this decade. A more ambitious agenda would be to achieve the doubling by 2008 (see Figure 9.4).

79 In recent years, some donors have announced significant increases in their commitments to foreign aid, most notably through G8 pronouncements at Monterrey, Kananaskis, and Evian. If donors honour existing commitments, aid to sub-Saharan Africa could rise to US$33.5 billion by 2008 and to US$36.1 billion by 2010[63]. Beyond these pledges, the Commission's recommendation for a doubling in aid levels (based on 2004 amounts) will require an extra US$18 billion per annum if this to be achieved by 2008 or an extra US$15.4 billion per annum achieved by 2010[64]. Figure 9.4 maps out the future trajectory of aid flows based on current commitments.

80 It must be emphasised that the proposed doubling in assistance would not be business as usual. Our recommendation is based on: (i) a radical change in the way donors behave and deliver assistance, and (ii) a continued, and expanded, strong improvement in governance in African countries. With a view to proceeding to the second stage and moving to the full programme by 2015, we suggest a review five years from now to assess the basis for a further expansion of external support of US$25 billion per annum. We turn now to issues regarding expenditure priorities that more aid might support and how the extra finance might be productively absorbed.

9.3.5 What assurance is there that the extra aid will be used productively?

81 Despite glaring needs across Africa, there is a limit to the number of roads, schools, clinics and water points that can be built and serviced effectively in any one year. For example, the required number of technical experts and managers to plan and budget extra finance may not be available to make productive use of the resources. The extent to which resources can be productively absorbed into economies is circumscribed by macro-economic, institutional, physical, human, social, cultural, and political factors. From a large amount of credible research and analysis, we now know that the effectiveness of aid depends on aid delivery and on the recipient country's governance and overall conditions – the more propitious the latter, and the higher the quality of the former, the more effective will aid be.

82 Annexes 1, 2, 3, and 6 bring together various strands of arguments made throughout this chapter regarding the effectiveness of aid to sub-Saharan Africa. Together they demonstrate that there is a virtuous circle of mutually reinforcing actions which donors and governments can take in making aid more efficient and effective. This requires donors to provide better-quality aid, which in practice means adjusting donor procedures and processes to suit recipient-country circumstances better. And it requires aid-receiving governments to create a more conducive policy and institutional environment for attracting more resources for public and private investment. To increase absorptive capacity further, macro-economic management must improve, especially management of monetary and exchange rate policies, and so must public financial management. Donors will not improve aid delivery much without concomitant improvements in recipient countries' public financial management, public administration, and public accountability systems.

83 In many parts of Africa, country conditions and the quality of donor assistance have been improving, creating conditions for further assistance to be used well. However, there is much more scope for further improvement. Although the alignment and harmonisation of donor support is now better than in the mid-1990s, progress is limited to a few successful cases (See Annexes 1, 2, 3, and 6). Problems of donor fragmentation and multiple parallel procedures remain pervasive, and tying of aid reduces its value substantially, with estimates of the reduction around 20 per cent. Better aid would allow stronger institutions of governance and development to emerge, which in turn would allow higher absorption.

84 What about increasing levels of aid to countries where states and governments are fragile, because of various forms of conflict, poor public-sector management, corruption, and where the absorption of increased aid presents special challenges? Evidence commissioned by the OECD/DAC shows that in countries where states are perceived as being fragile, of which many are in sub-Saharan Africa, donors provided as much as 43 per cent less aid between 1992 and 2002 than the level that these countries' performance ratings (CPIA) suggested might have been possible to absorb[65]. In this sense, these countries have been significantly under-aided, which could be corrected if donors adopted

more innovative approaches in supporting reforms in such environments (including better co-ordination). Analysis also shows that aid receipts by fragile states are twice as volatile as those to other low-income countries. The relative neglect of these countries by the international community is costly, not least because it is estimated that countries neighbouring fragile states bear annual losses in the order of 1.6 per cent of GDP[66]. Countries with weaker and less stable institutions, for example those emerging from conflict, also face bigger development challenges, notably in health and sanitation, child immunisation, malaria, and access to drinking water.

85 Although it is more complex, donors can ramp up aid levels to such countries and help to reduce poverty. Donors are giving increasing attention to these issues in recognition of the fact that without greater attention, poverty reduction and collective security goals will not be achieved. A recent Senior Level Forum on fragile states in London (14-15 January 2005), concluded that the risk of inaction was far greater than donors not taking any action at all. At this meeting, Draft Principles of Good International Engagement were tabled – see Annex 7 for details. Where conditions are less robust, for example in countries where states are fragile, and where donors and governments disagree on policy priorities, it should still be possible for donors to provide adequate and effective aid in ways that do not undermine national systems, and/or long-term sustainability[67]. These include:

(a) ensuring transparent information on aid flows to countries regarded as having fragile states or governments;

(b) making aid more effective at reducing conflict, improving the understanding and analysis of risk factors, and being willing to provide better responses to risk, for example by addressing issues of inequality and human security (see Chapter 5);

(c) sustaining a commitment to reducing poverty in difficult environments and developing more innovative ways of being effective;

(d) engaging in countries over the longer term, and providing less volatile and more predictable funding, even when threatened by temporary setbacks;

(e) increasing funding by about 40 per cent, which should be possible without damaging the norms of efficient aid allocation, as suggested by Collier and Dollar (2004);

(f) investing in those interventions that recent research suggests can help countries with weaker and less stable institutions to experience rapid turnaround. The benefits of these interventions can be as high US$80 billion[68].

86 In conclusion, our assessment indicates that over the next three to five years aid levels could be doubled and be used productively. Higher absorption of aid should be possible with:

(a) continuing policy and governance improvements within Africa;

(b) better allocation so that a broader range of countries can receive assistance, and through appropriate channels – budget and sector support where possible, and non-state channels where necessary;[69]

(c) better quality assistance.

9.3.6 Are public financial management systems improving, and are international efforts in supporting these getting better?

87 A well-performing public expenditure system is indispensable for increasing the effectiveness of all publicly channelled resources (including aid) and enhancing accountability to citizens. Within Africa, the importance of improving public financial management (PFM) systems is increasingly being regarded as critical for enhancing

development effectiveness. For example, AU/NEPAD's APRM explicitly recognises the significance of building better capacity in African countries for strengthening economic governance[70]. Most recently, an initiative to facilitate cross-learning, and the dissemination of information on good practice, was launched[71].

88 Since the enhanced HIPC debt-relief initiative was implemented, an increasing proportion of external assistance has been channelled through government systems of aid-recipient countries. These funds have been provided both in the form of debt relief, and as general and sector budget support. From a donor perspective, this has made it more important than ever to support improvements in the overall management of the budget, and since 2001, efforts to improve public financial management and accountability systems in poor countries have intensified.

(a) With the greater interest in these issues have come better measures of how well governments manage their money. The forthcoming Africa Governance Report by the ECA shows economic and political governance in Africa as having improved significantly over the last ten years or so.[72] Moreover, as Chapter 2 indicated, between 1999 and 2003, World Bank CPIA governance scores for sub-Saharan African countries also improved. Whereas the CPIA scores are survey-based assessments of many aspects of governance, we now have new detailed evidence based on careful examinations of country budget processes in 2001 and 2004. Following up on an earlier survey in 2001, which assessed standards of public expenditure management (PEM) in HIPCs, a recent joint World Bank and IMF progress report for 25 countries (22 of which are African), shows that in 2004 PEM systems had strengthened in several countries[73]. On average improvements were small but significant, reflecting amongst other factors the short assessment period, and some countries making great strides.

(b) Several countries have improved budget codes and standards, as a direct consequence of country authorities implementing action plans adopted by HIPCs following the first assessment by the World Bank and IMF in 2002[74]. Each country surveyed in 2001 undertook to implement Assessment Action Plans (AAPs). Progress by the 2004 survey showed, for example, that: PEM areas that were the weakest in 2002 had "improved significantly. in most cases";[75] furthermore, where implementation of AAPs was the strongest, PEM indicators had improved the most (e.g., in Ghana, Mali, Senegal, and Tanzania).

89 In short, while there is considerable diversity in country progress, financial management on average in this set of poor countries has clearly improved. This success has resulted from strong commitment by some HIPC governments to implementing PEM

Table 9.3: **Improvements in Revenue Mobilisation in Developing Countries 1999-2003 (Average CPIA Ratings)**

	Efficiency of Revenue Mobilisation	
Category	**1999**	**2003**
All Developing countries	3.27	3.56
Low Income Countries	3.09	3.32
SSA (37 countries)	3.11	3.36

Note: Table entries are mean values for indicated country groups. Ratings are on a rising scale of 1-6

Source: World Bank CPIA Database and World Bank and IMF, 2004

Table 9.4: **The Fiscal Effects of Aid in Selected African Countries**

Country	Impact of oda on: Domestic Revenue	Development Budget	Recurrent Budget
Ghana	++	+	++
Malawi	+	++	--
Uganda	+	++	++
Zambia	--	++	+

Symbols: ++ strongly positive; + moderately positive; -- strongly negative.
'Development Budget' corresponds to investment.

Source: Osei et al, 2003 and Fagernas and Roberts, 2004

reforms, combined with co-ordinated donor support to governments' action plans. Successes have been greater where plans have been focused and narrow, and where fewer donors have been involved in backing national efforts.

90 In an earlier section of this chapter we noted that tax-to-GDP ratios in sub-Saharan African countries are not out of line with those of other developing countries. Given the relatively high aid receipts of these countries, this suggests that past aid flows have not led to any overt slackening in revenue mobilisation. Moreover, Table 9.3 shows the 'Efficiency in Revenue Mobilisation' criterion (which the World Bank uses as part of their annual CPIA scoring) as having risen by eight per cent (between 1999 and 2003) for 37 sub-Saharan countries.

91 Country studies considering the fiscal impact of aid show that aid has, on balance, had a positive impact on revenue collection efforts. Indeed, as Table 9.4 indicates, aid has had a beneficial effect on public investment and on recurrent budgets.

92 Country examples regarding the fiscal impact of aid reveal interesting results:

(a) In Ghana: "it appears that aid has been used as a substitute for domestic borrowing. It also appears that aid has been associated with increased tax effort";[76]

(b) In Malawi: "It [aid] has also been associated with high fiscal resource mobilisation and lower domestic borrowing. (..) aid inflows have closely tracked the fluctuations in the volume of public expenditure, thus offsetting some of the destabilising effect of gyrations in domestic financing";[77]

(c) In Uganda: "Estimated domestic revenues are shown to have increased in response to inflows [of aid]. The estimated effects of inflows on domestic borrowing have been insignificant, suggesting on the one hand, that there was no explicit policy of using aid to achieve fiscal savings, but, on the other, that the receipt of aid was not the pretext for abandoning fiscal control";[78]

(d) But the experience has not been positive everywhere, for in Zambia: "injections of external financing have had... negative and sustained impacts on domestic revenue", and further: "aid in Zambia has thus not for the most part been used to stabilise the economy, or to offset the shocks to which it has been subject".[79]

93 Overall, it seems that economic governance among many sub-Saharan African countries has been improving strongly over the past few years, and that significant elements of progress have been associated with external support.

9.3.7 What would the extra aid be used for, and to achieve what?

94 Detailed expenditure priorities will emerge from African-led processes, and rightly so. Nevertheless, the Commission has identified sectoral priorities, reflected in Table 9.2a. In some cases, investing in these sectors will mean supporting existing plans and programmes that are currently underfinanced[80]. In other cases, current knowledge for improving livelihoods has yet to be translated into actions; but with available finance, projects and programmes could be initiated quickly. We examine the sectors briefly in turn – the breakdowns in Table 9.2a are based on Chapters 4 to 8.

95 If it is used well – as the Commission believes it can be, with continued improvements in governance and especially financial management – the extra investment in infrastructure should enable African economies to grow by up to 0.5 percentage points extra per annum. Exogenous shocks would be cushioned more effectively by a properly financed shocks facility, allowing more continuous growth. And an increase in expenditure would help to improve outcomes in primary education and health across sub-Saharan Africa.

96 HIV and AIDS constitute a special, enormous and urgent crisis particularly for Africa, but also the world. Our recommendations include at least US$10 billion per annum for HIV and AIDS. However, the unprecedented nature and scale of this emergency means that there is a case for considering this expenditure as being beyond 'normal' oda requirements.

97 With more resources now, it should be possible to make interventions at various levels of government and the economy. It is important to recognise that investing in the MDGs today (and intensifying efforts to combat HIV and AIDS and tropical diseases) will expand sub-Saharan Africa's future capacity to accelerate development: Africa will have more skilled people to design and build the necessary infrastructure, to deliver services, and to provide the managerial know-how for planning, organising, and implementing activities.

98 As mentioned before, we recommend a two-stage approach in which our recommendations would be implemented in a measured way, financed through gradually increasing external and internal resources. It is not straightforward to demonstrate in advance the full effect of actions and resources, but the full programme is oriented toward the following results:

(a) by 2010, GDP growth rate to reach seven per cent per annum;[81]

(b) by 2015, cultivated area under irrigation to rise by five million hectares (0.5 ha/year), leading to net productivity gains of 3.4 per cent per year;[82]

(c) by 2010, all people in Africa requiring anti-retroviral treatment will receive it;

(d) by 2010, HIV infections among young people will be reduced by 25 per cent;

(e) by 2010, five million Orphans and Vulnerable Children provided with access to basic services;

(f) by 2015, 40 million allowances provided as child support and disability support, at US$6 per month;

(g) by 2015, Universal Free Primary Education achieved;

(h) by 2015, Secondary Gross Enrolment Rate to reach 50 per cent;

(i) by 2015, free access provided to basic health services;

(j) by 2015, health workforce tripled, thus adding one million doctors and nurses;

(k) between 2006 and 2015, through immunisation coverage, over five million children's (under five years old) lives saved, and five million adult deaths prevented;

(l) annually, 500 million more people treated by chemotherapy programmes against debilitating parasitic diseases;

(m) by 2006, 380 million African women and children protected against vitamin and mineral deficiency;

(n) by 2015, 95 per cent of pregnant mothers and children to have received a bed net and treated for malaria;[83]

(o) by 2015, treatment of Tuberculosis increased to 70 per cent of cases.

99 None of these outcomes are guaranteed, of course. In fact, they are all 'stretch targets'. They depend on both increased support from the international community and continued improvement in governance, and probably even good fortune as well. But the speed of advance in many countries over the past half-century makes us aware of the tremendous possibilities; and the depth of African poverty is such that we must set ambitious goals.

100 At a country, regional, or continental level, there are a number of areas and sectors listed below where additional financing could be relatively quickly and effectively absorbed, i.e. at the beginning of the first stage of our measured approach. The Commission's recommendations are that the international community move rapidly on the following actions:

(a) in HIV and AIDS, change the way donors and global health partnerships deliver funds by providing an extra US$5.2 billion to US$11.3 billion over the 2005-2007 period;[84]

(b) in education, enable implementation of the Fast Track Initiative (FTI) with supplementary finance (of roughly US$1.9 billion), to start intensive teacher recruitment and training, and prepare for a substantial expansion in basic education;

(c) in health, build up the capacity and human-resource skills for delivering better, and scaled-up, services. Thus immediate support might be extended to support AU/NEPAD's Health Strategy and the Initial Programme of Action to strengthen basic health care systems. Other measures for which extra resources are of great importance and can be absorbed quickly include GAVI, polio eradication and vaccine development;

(d) in the area of social protection, provide funding for already-advanced plans for supporting orphans and vulnerable children in 17 countries (at a cost of roughly US$30-40 billion);[85]

(e) in infrastructure, proceed with implementation under the AU/NEPAD framework, where priority plans have been drawn up by regional organisations, and where implementation is held up by a lack of funds;

(f) in agriculture, raise agricultural productivity and reduce rural poverty, by implementing known small-scale irrigation technologies;

(g) with regards to reducing the impact of unanticipated economic and natural disaster shocks, financing and implementing a new shocks facility;[86]

(h) with regards to peace and security, to act faster in clearing arrears, creating the UN Peacebuilding Fund, and expanding the World Bank's Post-Conflict Reconstruction Trust Fund.

Would extra aid hit export competitiveness?

101 As explained in Chapter 8, regardless of what aid is spent upon, the external funds it provides can only buy imports. For example, if aid is used to pay local teachers, aid dollars are sold in exchange for the local currency that is used to pay them. The aid dollars are sold largely because people purchase them in order to buy imports. Extra aid increases the capacity to import. While this can bring many benefits, it can also hurt exporters. In effect, aid competes with exporters as the means by which imports are financed. Extra aid can result in an appreciation of the 'real exchange rate', increasing the amount of dollars local currency can buy, and so reducing the domestic returns from earning a dollar from exports.

102 A key part of a viable growth strategy is for Africa to diversify and dramatically increase its exports. It would be ironic if the aid meant to support that strategy had the unintended consequence of making exporting even less competitive than it is already. Further, in much of Africa, exporters are predominantly low-income farm households, and so an adverse effect would be particularly serious. The way Nigeria's oil dollars severely damaged its other exports, thereby hurting farmers, is an example of the process which an aid push must avoid.[87]

103 Unless actions are taken to offset the exchange rate appreciation effect, export competitiveness will deteriorate substantially if aid is doubled. There are no magic central banking strategies to prevent the problem: the policy of 'exchange rate protection' sometimes adopted in Asia would involve simply accumulating the additional aid in foreign exchange reserves. In effect, with such a strategy, the extra aid would not be used. There are, however, two complementary policies that would preserve export competitiveness.

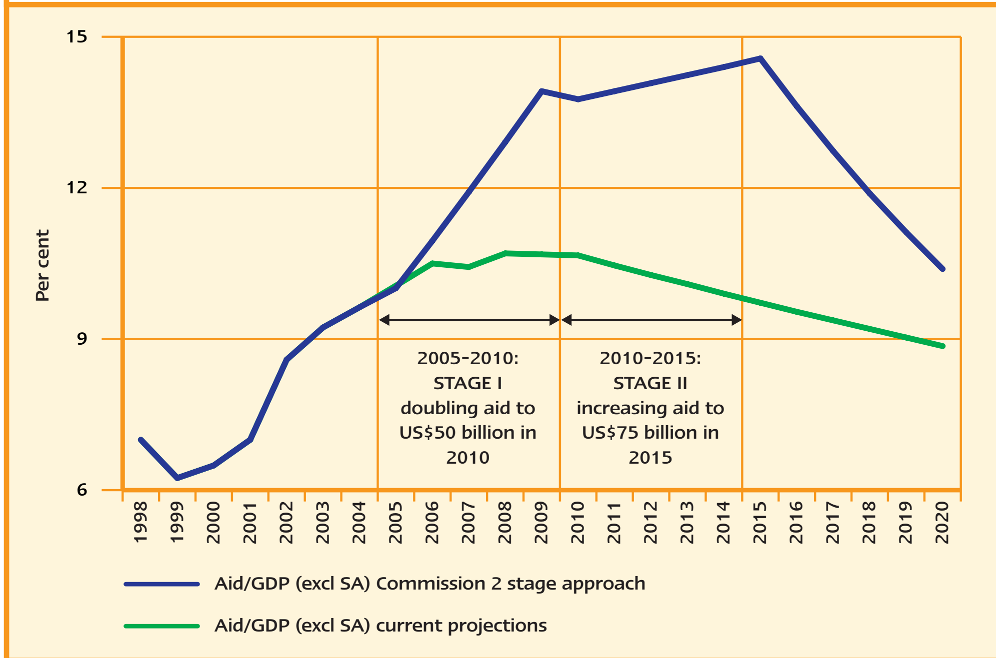
104 The first is for much of the aid to be spent on investments that bring down costs for exporters. For example, aid can be spent on improving transport and the functioning of ports. Precisely what spending would be most effective will vary country by country, depending upon the composition of existing and potential exports, and upon the structure of their costs. However, there is a lot of scope for cost reduction: for example, transport costs are a much larger percentage of exports for Africa than for other regions.[88]

105 The second policy is to increase the *demand* for imports by an amount corresponding to the increased *supply* of imports that will be purchased by the extra aid. Aid spent on importing medicines, for example, does exactly this. The additional instrument which governments can use for this purpose is trade policy. African governments have already reduced their trade barriers substantially, but to preserve export competitiveness in the face of a doubling of aid they will need to do more. As noted above, African governments remain heavily reliant on trade taxes for their revenue. Hence, one necessary use of aid may be to meet the loss of revenue caused by reduced trade taxes.

106 Donors should probably not insist that every dollar of extra aid be used for extra public spending: the preservation of export competitiveness may require other priorities. The need to match extra aid with extra import demand, and the implications for tax revenue, is an example of the co-ordinated actions that will be needed between developed-country governments and African governments. A co-ordination failure – such as donors expanding aid, but recipient governments not changing trade policy – would risk contracting exports onto an even narrower range of primary commodities.

107 Recent experience of the potential (negative) impact of high levels of aid on the real exchange rate suggests that it is modest[89]. Simulations for certain countries, notably for Uganda and Ethiopia, also find that increasing aid over the short to medium term would have only moderately deleterious effects within the exporting sector from an appreciating real exchange rate, which would be more than offset by positive productivity-improving effects of increased aid (of the sort mentioned above – see Annex 2)[90].

Figure 9.5 **Projections of Aid to Sub-Saharan Africa (excluding South Africa) Under Different Assumptions of Economic Growth and Aid Flows.**



Note: For the Commission's two-stage recommendation, with additional aid, total assistance to sub-Saharan Africa in 2010 would reach US$50 billion (Stage I). Between 2010 and 2015, the increase in aid would continue, and would reach US$75 billion in 2015 (Stage II). In the first-stage, we assume GDP growth would accelerate to reach seven per cent in 2010, and would be sustained at this level throughout the second-stage, and until 2020. Were current trends in growth and aid flows to continue, we assume economic growth in sub-Saharan Africa would remain flat at four per cent throughout both stages, and until 2020. Under this projection, aid to sub-Saharan Africa would reach US$36.1 billion in 2010, and thereafter would grow at 2.1 per cent per annum, in line with the GDP growth rates of OECD countries.

Source: Based on OECD/DAC, 2004 and 2005 and Commission's estimates.

Is extra aid forever?

108 The language of aid 'dependency' implies that recipients of aid become permanently reliant upon it. This happens only where the growth process fails, and in that case, aid would have to be reconsidered. But as we have argued, the failure of the African growth process cannot be attributed to a malfunctioning of aid. Figure 9.5 shows projections for the aid-to-GDP ratio (excluding South Africa), with the Commission's recommendations taken into account. It illustrates that when the Commission's recommendations are implemented, the ratio of aid-to-GDP would reach a peak in 2015 and would decline fairly quickly thereafter[91]. This provides a graphical illustration of a 'big push' sustained over 10 years. As African growth rises, aid-to-GDP ratios will fall and, eventually, so too will aid.

109 Where the growth process succeeds, aid tapers out. This has happened around the world. For example, South Korea has switched from being a recipient of aid in the 1960s to a contributor of aid in the 1990s. Within Africa, Botswana has made a similar transformation over 30 years from being highly aid-dependent to a successful middle-income country (see Annex 8 of this Chapter for more details). The world will be faced with a permanent aid programme to Africa only if national reform efforts are too small and/or implemented ineffectively.

9.4 How does debt relief fit in?

110 **Recommendation: For poor countries in sub-Saharan Africa which need it, the objective must be 100 per cent debt cancellation as soon as possible. This must be part of a financing package for these countries to achieve the MDGs, as promised in Monterrey and Kananaskis. The key criterion should be that the money be used to deliver development, economic growth and the reduction of poverty for countries actively promoting good governance. Accordingly, work should begin immediately to establish a transparent debt compact to include all sub-Saharan African low-income countries, including those excluded from current schemes. It should cancel debt stock and debt service by up to 100 per cent, and cover multilateral and bilateral debt. As an urgent measure, financing should immediately be put in place to provide 100 per cent multilateral debt service cancellation, where this is necessary to achieve the MDGs.**

111 The Enhanced HIPC Initiative has had a positive impact in reducing debt stocks in a number of African countries. 27 countries are currently benefiting from debt service relief, which over time has amounted to over US$50 billion. However, it should also be noted that some of the debt written off under HIPC could not have been repaid. In the case of this debt, debt 'relief' merely relieves the creditor of a balance sheet fantasy, and does not free up any actual resources for Africa. HIPC debt relief was intended to bring debt down from an 'unsustainable' to a 'sustainable' level; this language suggests an accounting clean-up on the balance sheet. There was an inconsistency between this ostensible criterion for relief and the discussion of how the relief should be spent by governments[92]. In practice, the 'sustainable debt' levels that were set were not derived from convincing economic analysis, although for some countries, the enhanced HIPC initiative released real resources for new expenditure. Despite this, there is widespread recognition that the relief provided under the initiative has not been wide enough, or deep enough.

112 Several low-income countries in Africa have been unable to benefit from the enhanced HIPC initiative, including Nigeria. Some non-HIPCs may require stock relief to relieve debts that are 'unpayable'. Beyond this, additional relief would be on debt that could have been repaid[93]. To support reform, the criteria on which debt relief should be granted should therefore be similar to those applied for aid – the main resources transfer.

Table 9.5: **Total Debt Service Paid by Sub-Saharan African Countries in 2003**

(Figures for 2003, in US$ billion)	Paid to bilateral lenders	Paid to multilateral lenders	Paid to private creditors	Total
HIPC's	1.1	1.1	0.1	2.3
Other low-income countries	1.1	0.7	1.8	3.6
Of which Nigeria	*0.8*	*0.5*	*0.3*	*1.6*
Middle-income countries	0.3	0.2	2.3	2.7
Of which South Africa	*0*	*0*	*2.1*	*2.1*
TOTAL	**2.4**	**2**	**4.2**	**8.6**

Source: World Bank, 2004a

Debt relief is highly efficient compared with other aid modalities in that it can deliver flexible long-term, untied, predictable and on-budget resources. In practice, Martin et. al. note that there have been problems in the delivery of HIPC relief which have undermined its effectiveness, and which should be addressed in future relief efforts by reducing conditionality and enhancing country ownership.

113 Future relief should also move away from the confusing language of 'sustainability', which provides increasingly inappropriate guidance on the allocation of a resource transfer the deeper the debt write-off becomes. It must instead focus on a country's capacity to utilise resources effectively for poverty reduction and growth.

114 In 2003, the total (public) debt service paid by all sub-Saharan African countries amounted to US$8.6 billion[94]. Of this, US$2.4 billion was paid to bilateral lenders, US$2 billion to multilateral lenders, and US$4.2 billion to private creditors[95]. These amounts include debt paid by low-income countries, which are not eligible for debt relief under the HIPC programme. Debt servicing by these countries is not trivial. Nigeria, for example, paid US$1.6 billion in debt servicing in 2003, or almost 20 per cent of the total for sub-Saharan Africa (Table.9.5).

115 With gradually more countries receiving 100 per cent bilateral debt relief under the enhanced HIPC initiative, and the accompanying additional relief from many Paris Club creditors, the emphasis now must turn to the servicing costs of debts owed to multilateral creditors. Debt-service payments of low-income African countries to multilaterals are estimated to be roughly US$1.2 billion in 2005; of this amount, the share owed by 32 countries eligible for HIPC-relief will be 90 per cent[96]. Information for the HIPCs confirms that projected debt service costs remain high, and further bilateral and multilateral relief would enable countries to shift public expenditure towards their priorities for poverty reduction[97].

116 Recent research points to a significant negative (statistical) relationship between debt service payments and economic growth: debt service is basically negative aid[98]. A high debt stock is also an inadvertent signal of future problems, such as upcoming tax increases that will be needed to repay the debt. Rather than assuming this future tax liability, potential investors are inclined to take their money elsewhere. There is evidence that large debts discourage private investment[99] and increase capital flight[100].

117 Analysis of Africa's debt also indicates the need to give priority to frontload liquidity to indebted countries so that spending on MDG-related activities can be increased. 100 per cent multilateral debt service cancellation and further bilateral debt *service* relief, would help to achieve this. Debt relief arrangements should be expanded to include all sub-Saharan low-income countries, including those excluded from current schemes.

118 Existing debt relief initiatives have generated (and are scheduled to provide) a range of positive results. But an assessment of African countries' debt profiles and the effects of creditor non-participation shows several problems: countries still have high debt-service ratios, there are delays in providing relief, and the impact of external shocks continues to be felt. Only four countries have succeeded in getting to 'sustainable' levels of debt by the narrow HIPC criteria[101].

119 It is estimated that if half of all debt service reduction were to be channelled to productive public investment, growth in HIPCs would accelerate by 0.5 per cent per annum, over and above any 'debt-stock overhang' effects (i.e., from private investment being deterred by high public debt stocks).[102] It has been suggested that as most debt relief in HIPCs goes towards increasing public investment, the additional effects of debt-service relief on GDP growth are probably almost one per cent a year.[103]

120 In addition to the core recommendation made above regarding debt cancellation, Annex 9 elaborates a further proposal to assist HIPCs address problems (including law suits) caused by debt owed to non-OECD bilateral and commercial creditors which are not participating in the HIPC Initiative. These debts are causing HIPCs considerable difficulties. Effective new measures of the kind mentioned in Annex 9, including the establishment of a rapid-response legal technical assistance facility, would help to bring down avoidable debt burdens.

121 Limiting both the stock of debt and providing debt service relief until 2015 would help to address moral hazard problems, in the sense that countries would be tempted to take on more debt in the hope that it too would be written off. The measures proposed here are intended to clear the slate for a fresh start, and to maximise the amount of resources available to countries for achieving the MDG's. It is an economically sound approach; but to be effective, the debt relief must be substantial, it must be financed with additional resources, and must be executed in a way that does not put countries at risk of accumulating unsustainable debts in the future.

122 The debt-relief compact we are proposing has not been costed (and is therefore not included in Table 9.2a). However, 100 per cent multilateral debt service relief for all sub-Saharan African countries would cost less than US$2 billion per annum and could be included with the aid package in each of the two stages of additional finance outlined above.

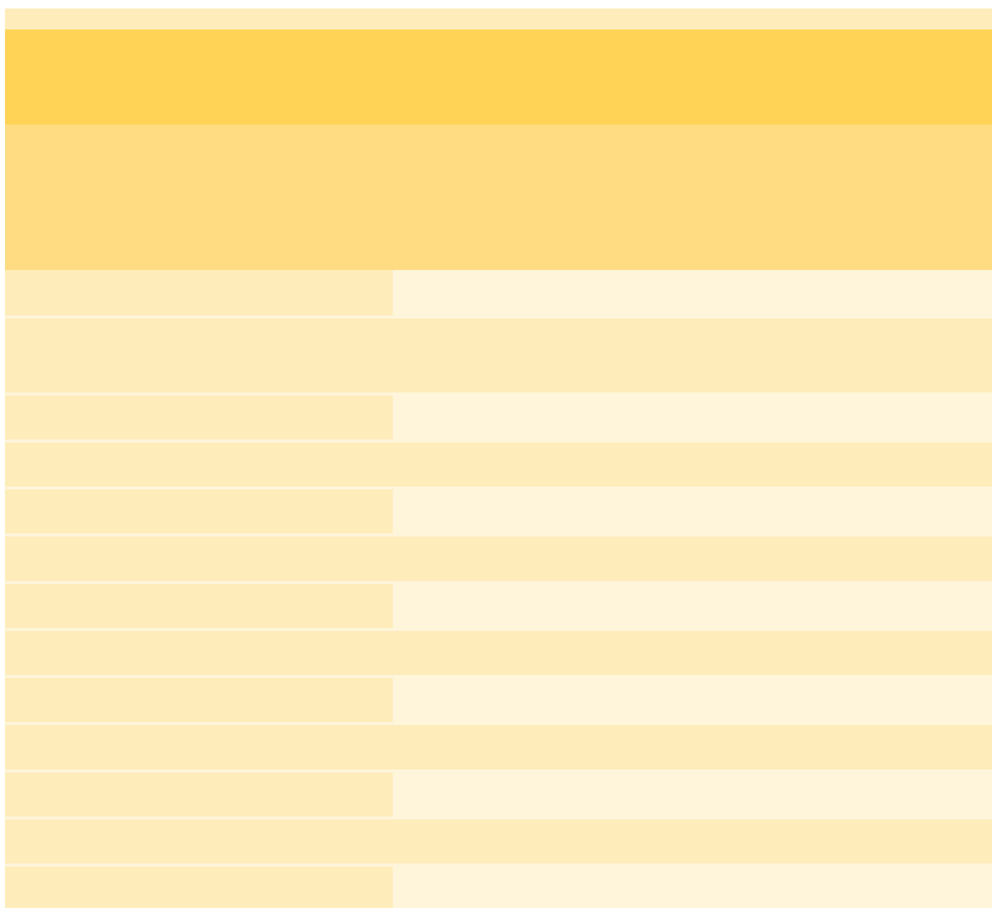
9.5 Paying for extra aid[104]

123 **Recommendation: Donor countries should commit immediately to their fair share of the additional US$25 billion per annum necessary for Africa. Ways of financing the doubling of aid to Africa should include the immediate launch of the International Finance Facility. Rich countries should aim to spend 0.7 per cent of their annual income on aid, with plans specified for meeting this target. Further work should be undertaken to develop workable proposals for specific international levies to raise additional finance (for example from compulsory or voluntary charges on airline tickets).**

9.5.1 The global requirements for aid

124 Despite the commitments made at Monterrey and other initiatives to increase oda levels (at Barcelona with respect to EU member states; and the Millennium Challenge Account (MCA) in the case of the United States), the MDGs (globally) remain under-financed, as the report of the UN Millennium Project has so clearly shown. And our analysis has further demonstrated the urgency and scale of the need for extra resources. As Table 9.6 makes clear, even if OECD/DAC member countries fulfilled their Monterrey commitments by 2006 (globally raising an estimated additional US$19 billion), this would still leave significant additional resource requirements – assuming, at the lower end, an extra US$50 billion is required for meeting MDGs globally. Extra resources must be found now if there is to be any chance of making the 2015 targets.

125 Assuming donor countries honoured their Monterrey commitments to provide an extra US$19 billion by 2006, on current shares, this would amount to an extra US$6.6 billion for sub-Saharan Africa (increasing aid from US$23.8 billion in 2003 to US$30.4 billion in 2006; see Table 9.6). Over the medium term, substantially more money



(1) Projections to 2006 taken from OECD/DAC (2004) include Monterrey commitments. A similar growth rate is then used to calculate aid flows for both DAC donors and Multilaterals under 'To all developing countries' and under 'To sub-Saharan Africa'. Non-DAC bilateral aid flows are assumed to remain constant over the projection period.

(2) GNI is assumed to grow by 2.1 per cent per annum (OECD/DAC, 2004).

(3) There is a difference between total oda from donors and total oda to developing countries. This is mainly because capital subscriptions to multilateral institutions by bilaterals are not always drawn down in the same year as they are being paid by bilaterals.

(4) DAC members/multilaterals projected contributions to sub-Sahraran Africa (for period 2004-2006) proportional to its 2003 share.

Source: OECD/DAC, 2004 and 2005, and Commission's estimates

will obviously need to be raised. Doubling aid from projected 2004 levels would mean aid to Africa reaching US$51.5 billion in 2008/10.

126 Raising money and building mechanisms to spend resources effectively presents a chicken-and-egg problem. Until there is a credible indication that major increases in resources will be available, donor agencies and recipient governments will not act to prepare delivery systems. Yet, until delivery systems are improved, decision-makers will not commit large increases in resources. In such a situation, each party responsible for actions ends up blaming the other for immobility.

127 The way to break out of this cycle is for donors to commit now, clearly and strongly, to a build-up of resources over the medium term. As discussed below, such a commitment can be agnostic as to which kind of financing mechanism is eventually used. There are a variety of options available. Faced with a credible commitment, African governments, the IMF, and the aid agencies will know how best to prepare for this. For example, medium-term expenditure frameworks can be developed to incorporate an increasing inflow of resources. Those countries ready with credible financial plans will be the first to benefit from the resource build-up.

9.5.2 Burden-sharing through meeting common norms

128 There is an enduring tradition of surprisingly successful agreements for international burden-sharing; a longstanding example is the co-ordination of military efforts through NATO, involving resources far in excess of those involved for global development assistance. A basic element in burden-sharing is benchmarking. For development assistance, the UN has adopted a target of 0.7 per cent of Gross National Income (GNI) for the OECD countries. And in thinking about this burden, let us be very clear that this burden is small: US$25 billion per annum in extra aid for Africa represents only 0.1 per cent of high-income country GDP.

129 The most credible, reliable, and durable approach to financing the MDG funding gap would be to make faster progress in increasing aid budgets and raising the oda/GNI ratio to 0.7 per cent. Recent evidence shows that while progress is being made – in that global oda in nominal terms rose from US$52.3 billion in 2001 to US$ 68.4 billion, i.e. 0.25 per cent of GNI, in 2003 – 87 per cent has not gone to countries struggling to reach the MDGs.[105]

130 A growing number of countries are announcing plans for reaching the 0.7 per cent oda/GNI target (including Belgium, Finland, France, Spain, and the UK). Announcements of similar timetables by other OECD/DAC members would be an extremely valuable advance along the road to fulfilling aid requirements. We should be very clear that the achievement of the increases we are arguing for by 2015, after completion of the first and second stages, would (assuming Africa's share of total aid stayed constant) still leave aggregate aid flows from developed countries well below 0.7 per cent of their total GDP.

9.5.3 Reallocating aid to Africa

131 Despite the importance of continuing efforts to meet the 0.7 per cent target, it is unlikely that substantial increases in oda will materialise in the immediate future. Domestic political and fiscal constraints in some developed countries are likely to delay substantial budget increases for development. An option for governments facing fiscal constraints is to reallocate existing aid budgets; aid has not been well allocated from the perspective of reducing poverty. Historically, the biggest single misallocation of development assistance has been that too great a share has gone to middle-income countries[106]. As shown above, although Africa is the only low-income region that is not growing, less than half of global aid goes to Africa. Within the context of a global increase in aid of US$50 billion,[107] a good case can be made for a refocusing of aid to low-income countries, and to Africa specifically to finance the big push that is needed to get the region growing.

9.5.4 Raising finance for development from international levies and other mechanisms

132 An additional and potentially important source is from the raising of finance internationally through levies or lotteries[108]. One example is a voluntary levy on airline tickets to reflect some of the costs inflicted by carbon emissions. For example, there could

be a US$5 charge per airline seat, which the traveller could decline to pay by ticking a box. Being voluntary, the levy could avoid many of the difficult issues involved in getting international agreement on taxation. And it would help people to face up to the consequences of their actions in terms of pollution and global warming.

133 Another alternative for raising additional finance for development, and which is mentioned in the recent Landau report[109], would be the allocation of Special Drawing Rights designed (SDRs) to benefit particularly developing countries. When the current allocation of SDRs was decided, the international community had not recognised fully the need to raise substantial funding for accelerating development in low-income countries. A new allocation for developing countries, or a redistribution of SDRs from developed countries, for example, might raise an additional US$50 billion for Africa over the next five years, and which could be administered from a special account. The funds made available to African countries would be issued at zero or low interest rates over a 10-year loan period, mixed with appropriate amounts of grant contributions from donor countries. The IMF should be required to provide an assessment of this suggestion as part of its examination of its institutional reforms described in the next chapter.

134 A number of other innovative proposals have been suggested to help raise additional funds[110]. Much attention has been devoted recently to reviewing these proposals, assessing their viability from a range of viewpoints: technical; political; administration; governance; implementation; compliance and enforcement; and compatibility with existing structures. Given the detailed treatments elsewhere – most notably in Atkinson (2003), Landau (2004), World Bank (2004d and 2004e), and Reisen (2004) – we do not propose a detailed consideration of the pros and cons of the different proposals. Further work should be undertaken to analyse and assess the political, social, and technical feasibility of specific international levies. Given the analysis already available, the challenge now is to move to concrete proposals for practical action.

135 The critical issue is to raise the finance needed for assisting African countries to take strong actions over the next few years in accelerating development. We have noted throughout this chapter that what matters most is for these actions to be financed effectively. Accordingly, each donor country should opt for raising the required amount of finance in ways that best suit their specific circumstances.

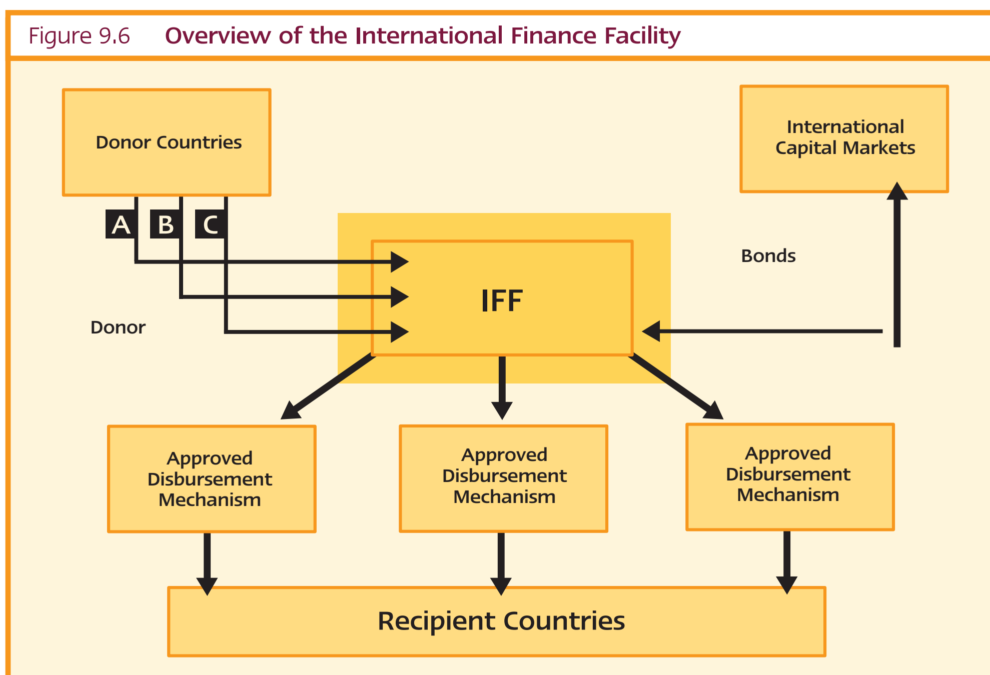
9.5.5 Frontloading aid by using capital markets

136 It may be that direct increases to aid budgets of donor countries and other means of sustainable revenues, such as levies and other voluntary mechanisms, can only build up more slowly than the resources needed to finance a big push. To accelerate progress in the near term, one option would be to immediately raise funds in capital markets, frontloading aid on the strength of future aid commitments already made by donors. The revenues needed to pay for a frontloaded 10-or 15-year hump in spending would then be smoothed out through borrowing. A big push to fight African poverty would be financed partly through donor borrowing, as in the case of other necessary spending bulges such as those during wartime. The proposal for an International Finance Facility (IFF) aims to do precisely this, and we recommend its immediate implementation[111]. We should recognise that the combination of rising incomes in developed countries, advances in their aid/GDP ratio toward 0.7 per cent, and graduation of some countries from aid-recipient status, will mean that flows to Africa could be maintained, over whatever period is necessary, beyond 2015.

137 The IFF, if implemented by all countries, would provide an additional US$50 billion a year in development assistance in the years to 2015, providing the funds necessary to reach the MDGs by 2015. Based on donors' legally binding long-term commitments, the Facility would leverage money from international capital markets by issuing bonds.

Bondholders would be repaid from future donor payment streams. The IFF would not require an increase in aid budgets from donor governments; it is founded on the additional aid commitments for the future that many countries have made, in particular the countries with commitments to reach 0.7 per cent.

Figure 9.6 **Overview of the International Finance Facility**



Source: HM Treasury, 2004

138 The IFF is not an alternative to swift progress by donor governments towards the 0.7 per cent oda/GNI target; indeed, its rationale depends on future commitments to increase aid. However, to halve poverty and achieve the MDGs, a surge in finance over the next 10 to 15 years is needed to complement other radical changes – in governance, in trade, and in security. As fiscal constraints can prevent donors from increasing their aid budgets in the short term, the IFF is an attractive option for increasing global levels of aid substantially as other changes occur, so that in combination they can have a concerted impact on tackling poverty. And in our case the extra finance forms a key element of a big push for Africa.

139 Frontloading aid through the IFF will enable countries to make the investments in economic growth in the short term that are essential to reduce poverty and to provide a chance to meet the Millennium Development Goals. Success will allow the lowering of aid requirements in the future. The long-term, multi-year commitments that donors would make to the IFF, according to an agreed set of high-level principles to ensure aid effectiveness, should increase the predictability and stability of aid, allowing recipient countries to make sustainable investments.

140 The IFF would not seek to become a new body for disbursing aid with new criteria that developing countries will need to meet, and would not establish a new aid bureaucracy. It would disburse aid using existing mechanisms that have been tried, tested and shown to be effective. For example, it is envisaged that the IFF would use a mix of existing successful multilateral and bilateral mechanisms and agencies (see Figure 9.6).

141 In sum, the IFF should: provide predictability in the long term; assure legally binding commitments; not be administratively demanding (although governance structures are still being discussed), and supplement current oda. The IFF would enable the international community to meet the global US$50 billion MDG-funding gap, of which half – US$25 billion – should go to Africa. The IFF is most relevant for donor countries that have not yet reached oda levels of 0.7 per cent of GDP or higher, as it would provide the necessary immediate increase alongside ongoing progress towards the target. It is impressive therefore that the Nordic countries that have already reached 0.7 per cent or higher have declared their support for the IFF.

Recommendations on Resources

To increase the growth rate in Africa, and to make strong progress towards the Millennium Development Goals, the volume and quality of external aid to sub-Saharan Africa must change radically. Aid to sub-Saharan Africa should increase by US$25 billion per annum over the next three to five years. This must be accompanied by a radical change in the way donors behave and deliver assistance, and by continued strong improvements in governance in African countries. We show that in these circumstances this increase in aid can be used effectively. Additional finance should be raised in various ways, including the immediate launch of the International Finance Facility.

Aid quality

- To improve the quality of aid an annual discussion should take place between the Development Ministers of the OECD countries and African Finance Ministers, along with representatives of civil society and international organisations. This should consider aid allocation criteria and make suggestions for a better distribution, including between middle and low income countries. In countries where governance and institutions are weaker, donors should seek to provide adequate and effective flows through appropriate channels, bearing in mind the need to avoid undermining national systems and/or long-term sustainability.
- Aid should be untied, predictable, harmonised, and linked to the decision-making and budget processes of the country receiving it. The length of the commitment should be related to the purpose: for example, aid for infrastructure and public expenditure support should be committed for terms longer than aid for technical assistance.
- Aid to Africa should be mainly in the form of grants.
- The use of policy conditionality associated with external assistance should be strongly reduced. Ways of strengthening mutual accountability, and of monitoring implementation, should be put in place. The activities of the IFIs and donors should support and not undermine, institutions of accountability in African countries, for example by helping countries to strengthen international codes and standards and by avoiding heavy burdens of reporting.
- Through a new facility, donors should help African countries to address problems caused by commodity-related shocks and natural disasters.

Aid quantity

- Aid to sub-Saharan Africa should be doubled, that is, increased by US$25 billion per annum over the next three to five years to complement rising levels of domestic revenue arising from growth and from better governance. Following a review of progress towards the end of this period, a further US$25 billion per annum should be provided, building on changes in the qualiy of aid and improvements in governance.

Debt relief

- For poor countries in sub-Saharan Africa which need it, the objective must be 100 per cent debt cancellation as soon as possible. This must be part of a financing package for these countries to achieve the MDGs, as promised in Monterrey and Kananaskis. The key criterion should be that the money be used to deliver development, economic growth and the reduction of poverty for countries actively promoting good governance.
- Accordingly, work should begin immediately to establish a transparent debt compact to include all sub-Saharan African low-income countries, including those excluded from current schemes. It should cancel debt stock and debt service by up to 100 per cent, and cover multilateral and bilateral debt.
- As an urgent measure, financing should immediately be put in place to provide 100 per cent multilateral debt service cancellation, where this is necessary to achieve the MDGs.

Financing mechanisms

- Donor countries should commit immediately to their fair share of the additional US$25 billion per annum necessary for Africa.
- Ways of financing the doubling of aid to Africa should include the immediate launch of the International Finance Facility.
- Rich countries should aim to spend 0.7 per cent of their annual income on aid, with plans specified for meeting this target.
- Further work should be undertaken to develop workable proposals for specific international levies to raise additional finance (for example from compulsory or voluntary charges on airline tickets).