# Using increased aid effectively


Over the next decade, African countries are expected to be the largest beneficiaries of increased donor aid, which is intended to improve their prospects of achieving the Millennium Development Goals. To help these countries assess the macroeconomic implications of increased aid and respond to the associated policy challenges, the IMF has published a study by its African Department: *Macroeconomic Challenges of Scaling Up Aid to Africa: A Checklist for Practitioners.*

The handbook is directed at policymakers, practicing economists in African countries, and the staffs of international financial institutions and donor agencies who participate in preparing medium-term strategies for African countries, including in the context of poverty reduction strategy papers. It provides five main guidelines for developing "scaling up" scenarios to help countries identify important policy issues involved in using higher aid flows effectively.

- **Seek to absorb as much aid as possible**: Countries can alleviate Dutch disease—when higher domestic demand raises the price of nontradables in relation to tradables and diverts productive resources away from the exporting sectors—by ensuring a high import content in additional public spending, focusing spending on infrastructure, and liberalizing trade. It is unclear how high the risks of Dutch disease are for Africa. The evidence is mixed: in some countries aid surges have been associated with real exchange rate depreciation.
- **Boost growth in the short to medium term**: Not all aid goes to activities that will boost growth (humanitarian aid and disaster relief, for example, do not), but aid used to build infrastructure (roads, irrigation, ports, and electricity) can be expected to boost growth in the short to medium term. Governments must adopt policies that will allow them to absorb more aid effectively and remain alert to emerging supply pressures in different sectors.
- **Promote good governance and reduce corruption**: Strengthening institutions for public expenditure management and public auditing and reducing corruption are likely to increase the benefits of aid, allowing more funds to be channeled to productive uses.
- **Prepare an exit strategy**: Governments must be prepared if, or when, the scaled-up aid returns to, or even falls below, normal levels. It may be difficult to cut back expenditures financed by higher aid, thereby increasing the pressure for higher domestic financing of deficits. Scaling-up scenarios need to include a strategy that countries can follow in such a situation.
- **Regularly reassess the policy mix**: Scaling-up scenarios are not forecasts. Their precision depends on both the amount of aid and the implementation of policies that allow countries to absorb the aid without such destabilizing effects as increased inflation, a loss of competitiveness, or a rise of debt to unsustainable levels. Countries and donors should regularly reassess the scenarios to update their vision for the future.

The handbook, written by Sanjeev Gupta, Robert Powell, and Yongzheng Yang, will be distributed at the seminar "Sources of Growth," to be held in Equatorial Guinea on March 14 and at a roundtable on the Multilateral Debt Relief Initiative and the IMF's role in low-income countries in Lusaka, Zambia, on March 16–17. IMF Managing Director Rodrigo de Rato will participate in both events. ■

Copies of *Macroeconomic Challenges of Scaling Up Aid to Africa: A Checklist for Practitioners,* by Sanjeev Gupta, Robert Powell, and Yongzheng Yang, are available for $25.00 each from IMF Publication Services. Please see this page for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

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