

Aid effectiveness: what can donors do?

The sometimes heated debate over the effectiveness of increased aid has typically centered on what recipient countries can do to make the best use of it. But donors can play a more constructive role, too. A new IMF Working Paper takes a closer look at the implications of long-term changes in the volume, form, and types of aid and argues that donor choices can make a difference.

Many analysts see aid as crucial in promoting the development of low-income countries that have little access to private capital. Aid can help build human capital and improve productive and export capacities. But persistently low growth and stubborn poverty in a number of developing countries have sparked a debate about the conditions under which aid is effective. In the past few years, the global community has acknowledged that a new approach is needed—one that couples greater country ownership of needed reforms in recipient countries with donor initiatives to increase aid, open markets to developing country products, and, most recently, provide extensive debt relief.

With scaled-up aid now in the offing, the debate has shifted to how to ensure that these resources translate into growth-enhancing measures, including longer-term investments in education and health care. Clearly, recipient countries will need to take more ambitious steps to improve governance and reduce corruption. Should more be asked of donors also? The Working Paper examines issues surrounding more generous and less volatile aid, as well as the types of aid that would be most conducive to helping recipient countries reach the UN Millennium Development Goals.

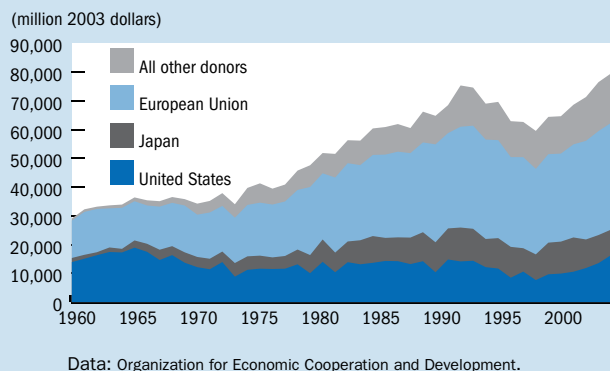
Volume and volatility

The 2002 Monterrey, Mexico, International Conference on Financing for Development reiterated a call for developed countries to allocate 0.7 percent of their gross national product (GNP) to official development assistance (ODA). As of 2004, however, only Denmark, Luxembourg, the Netherlands, Norway, and Sweden were disbursing assistance equaling or surpassing that target. The unweighted average of the aid effort in 2004 for the OECD's Development Assistance Committee donor countries was 0.42 percent of gross national income (GNI), whereas the income-weighted average ratio of ODA to GNI stood at 0.25 percent, suggesting that smaller donors are leading the aid effort.

The paper found that aid flows (dollar-denominated at 2003 prices) grew at about 3 percent a year from the 1960s through the 1980s (see chart above), experienced a significant

Picking up

Real flows of official development assistance dipped in the 1990s but have increased since the 2002 Monterrey conference.



reversal in the mid- to late 1990s (when aid flows dipped by 1 percent a year, on average), but picked up noticeably in the new decade after some countries responded positively to appeals made at the Monterrey summit.

Resource flows must also be predictable to enable recipient countries to formulate and implement long-term poverty reduction strategies. Aid tends to be procyclical and more volatile than GDP or fiscal revenues in developing countries. The study finds that disbursements by major donors, which were relatively stable between 1970 and the early 1990s, became more volatile between 1995 and 1999 and between 2000 and 2003.

Some part of the recent increase in volatility can be attributed to donors' debt forgiveness, which, as a onetime event, is inherently volatile. However, volatility remains high even when debt relief is excluded from aid flows, implying that the flows of development assistance have been less consistent in the new millennium. In general, aid from a specific donor is not distinctly more or less volatile than average. In the past, however, aid flows from Denmark and Norway were somewhat less volatile, whereas those from Italy and the United States were somewhat more volatile than the median. Since the 1990s, however, U.S. aid has become more stable.

There is also evidence that donors have responded to changing recipient needs over time, although differences in regional destinations are also likely to reflect evolving donor motivations. The sharpest regional shifts involve sub-Saharan Africa's rise and Asia's decline as aid recipients. Sub-Saharan Africa was the largest recipient of aid in 2003, with almost

30 percent of total ODA—a substantial increase from the 13 percent share it received in 1960. By contrast, Asia's share fell to 25 percent of total ODA in 2003—a sizable drop from the 40 percent of total assistance that the region accounted for in the 1960s and 1970s.

Composition concerns

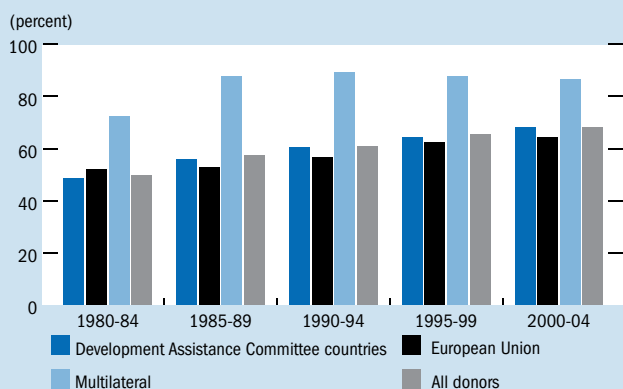
To what extent does the composition of aid influence local ownership and leadership of development plans and, hence, aid effectiveness? The paper analyzes this question in the context of recent long-term changes in the various components of aid.

Rising concerns about the heavy debt burdens of poor countries and increasing awareness of the length of time it takes for aid to have a positive effect on health care and education outcomes have led some donors to enlarge the share of grants. Since 2000, bilateral grants (see chart below) have grown, on average, by almost 7 percent a year—up from a growth rate of less than 2 percent a year in the 1990s. In the year after the Monterrey summit, for example, the United States increased bilateral grants by more than 40 percent in real terms.

The share of project lending in total lending has waned, whereas budget support has grown in importance. The latter affords recipient countries the flexibility to align their aid spending with national priorities and is more effective in countries with well-designed public spending programs. Budget support is also significantly more flexible than project aid, but tied aid is the least flexible of all. The paucity of donor-specific data makes detailed comparisons difficult, but the data indicate that donors such as Denmark, the

Rising grants

As a portion of overall aid, grants have been increasing.

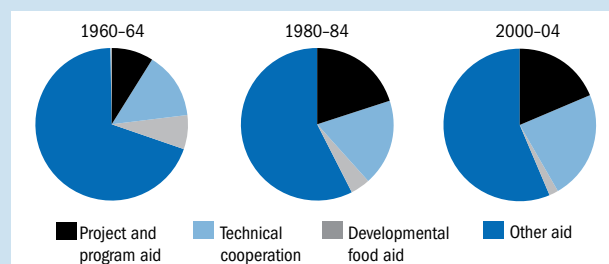


Data: Organization for Economic Cooperation and Development.

Shifting composition

Technical assistance now forms a larger part of donor aid.

(percent of total overseas development assistance)



Data: Organization for Economic Cooperation and Development.

Netherlands, and Sweden were tying less than 25 percent of their aid even in the 1980s, when about half of all aid was tied.

Since 1995, about 70 percent, on average, of all donor commitments of budget support have been in the form of debt relief. Has increasing debt relief been associated with reductions in other types of aid? This is a complex issue, but a simple analysis indicates that, although debt relief was negatively correlated with aid excluding debt relief during 1995–99, that correlation was positive for 2000–03. Put another way, this suggests that, although components of aid other than debt relief may not have grown as rapidly as total aid, there appears to be no evidence that debt relief has crowded out other forms of aid in the new millennium.

Particularly of note, too, is the rising use of technical cooperation, whose share of aid has nearly doubled (see chart above) since the 1960s. What implications might this have for recipients? Technical cooperation is a form of aid largely controlled by donors, who provide a great majority of this aid in the form of personnel or administrative costs, which accrue to donor-appointed agents. In a bid to make technical cooperation more results-oriented, donors now favor a short, production-oriented planning horizon. However, these arrangements afford recipients little control over the planning, implementation, or monitoring of the process. ■

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Copies of IMF Working Paper No. 06/1, "Are Donor Countries Giving More or Less Aid?" by Sanjeev Gupta, Catherine Pattillo, and Smita Wagh, are available for \$15.00 each from IMF Publication Services. Please see page 144 for ordering details. The full text of the reports is also available on the IMF's website (www.imf.org).